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Commercial bank failures in Montana

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159

COMMERCIAL BANK FAILURES IN MONTANA, 1920-1926

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TABLE OF CONTENTS

2444-81

LIST OF TABLES

Table | Page

Table Page

INTRODUCTION

The commercial bank failures in Montana during the 1920-1926 period were a tragic event in the state's history. Many areas were deprived of essential banking services and life-long savings disappeared as banks closed their doors. The human tragedy was extensive as financial losses left thousands penniless to fend for themselves; thousands left the state. The entire episode reflected environmental conditions as well as basic weaknesses in the banking system.

The commercial bank failures of this period represented a complex problem that involved social and political as well as economic aspects. Such a problem can be viewed from several vantage points. The events present numerous possibilities for study. Because of the impractical nature of adequately treating these many aspects within the present study, the examination is restricted to several economic aspects of the problem. Specifically the study examines the major causes of the commercial bank failures in Montana during the early 1920's.

The effect of environmental factors is examined as well as basic weaknesses in the banking system. What was the responsibility of governmental authorities in the tragedy? Were their actions responsible for the widespread failures? These relationships are examined with primary emphasis on the role of the Federal Reserve Bank of Minneapolis. Such emphasis is justified by the great importance of the Federal Reserve System to the banking operations of this period. Another vital environmental factor was the agricultural distress

during this period. Closely related to their local environment, bank operations in Montana reflected the agricultural distress of the early 1920's. These environmental factors--the actions of governmental authorities and agricultural distress--were important factors in the bank failures of this period.

Turning to an examination of the banking system, the study scrutinizes the financial strength of Montana banks. It asks the question: Was financial weakness a major factor in the Montana bank failures of the early 1920's? The study reveals a basic weakness which was a major cause of the bank failures during this period. In addition, the closely related problems of bank size and financial diversification are considered.

The bank failures of this period were largely the result of these factors. Certainly, no one reason can be assigned as responsible for the tragic events; a combination of factors resulted in the widespread wave of bank failures that left its mark upon the future.

CHAPTER I

THE SETTING OF MONTANA BANK FAILURES

During the short period of time between 1920 and 1926, more than one-half of Montana's commercial banks failed.[1] Of the 396 state and national commercial banks in operation in 1920, 214 had closed their doors within 6 years.[2] This tragic wave of bank failures was closely related to the economic conditions of the period.

The economy of Montana was primarily agricultural and was greatly affected in 1920 by the world-wide decline of agricultural prices. It is as an extension of international, national and regional economic conditions that the dramatic events in Montana are placed in their proper perspective. Conditions in areas outside of Montana played a major role in the crisis of the early 1920's even though peculiar local circumstances made the situation more severe than in many other areas.

The economic displacements caused by the First World War were the source of many of the economic problems of the early 1920's. National economies were highly specialized and trade patterns were a series of delicately balanced relationships. Generally the economic

[1]The term "failed" as used in this study includes: banks suspending operations; banks voluntarily liquidated; banks placed in the hands of receivers.

[2]Based on a tabulation of individual bank statements in the Annual Report of the Banking Department in Montana, Nov. 15, 1920-June 30, 1926, and the Annual Report of the Comptroller of the Currency, Sept. 8, 1920-Dec. 31, 1926. Only banks in operation on the beginning date are included. Failed banks are those banks that failed during this period.

welfare of these nations depended heavily upon trade. Not only were these associations disrupted by the war, but the financial and fiscal stability of many nations was seriously damaged. During the First World War gold flowed out of belligerent European nations to purchase necessary war materials and resulted in a reduction of their monetary gold supply. This one-way flow was a disrupting factor in world trade relations. Neutral nations experienced the opposite effect as the large inflow of gold created excess reserves and exerted pressure on existing prices. In addition to these factors, territorial realignments added further confusion to the economic problems of world trade.[3]

The shipment of gold bullion was not the only method used to finance the war purchases of belligerent nations. European countries liquidated large holdings of American investments; within a few years the United States became a creditor rather than a debtor nation. In addition, the United States extended large amounts of credit to finance European purchases.

Farm prosperity in the United States during the war resulted from the high prices received by farmers for their products and physical output did not increase materially until after the armistice. Following the armistice, European nations tried rapidly to rebuild their shattered economies. Each nation sought national self-sufficiency as far as possible. In keeping with this policy, European agriculture quickly regained its former productive capacity.

[3]The Brookings Institution, The Recovery Problem in the United States, The Institute of Economics of the Brookings Institution publication no. 72 (Washington, D. C., 1936), 3-4. Cited hereafter as Brookings Institution, Recovery Problem.

By 1925, the agricultural production of Europe reached its pre-war level.[4] This recovery had a great impact on agricultural conditions in the United States since the war-time prosperity of farmers was largely the result of the increased European demand. As European agricultural production increased and as the credits extended by the United States decreased, a price decline began that affected agricultural products around the world.

In the spring and summer of 1920, a world-wide price decline took place. The avalanche of descending prices engulfed most industries and individuals. It began with the collapse of the silk market in Japan and spread in wide circles around the globe. The countries of the Far East, India, Java, Australia, Europe and North and South America all were generally affected in the same way and at the same time.[5] This economic collapse ended the brief period of rapid expansion in the United States that followed the war.

The economy of the United States expanded rapidly during the years of the First World War. Between 1915 and 1920 the level of national income more than doubled. Farm income in 1919 was more than double the average annual amount for the five year period preceding the war. This increase in farm income was primarily the result of a 100 percent increase in the prices received by

[4]Brookings Institution, Recovery Problem, 13-14.

[5]U. S. Congress, Agricultural Inquiry, Hearing before the Joint Commission of Agricultural Inquiry, 67th Cong., 1st Sess., (Washington, 1924), II, 13. Cited hereafter as U. S. Congress, Agricultural Inquiry, II.

farmers for their products and only to a small extent by the 7 percent increase in agricultural production.[6]

During the years immediately following the war, agricultural and industrial production generally increased. During the years of the early 1920's, production was uneven. The world-wide price declines in 1920 were reflected in the production indexes of most basic commodities. Table 1 gives an index of production in several basic industries during this period. Table 2 illustrates the changes in agricultural production.

TABLE 1

INDEXES OF PRODUCTION OF BASIC COMMODITIES[a]

Item	1919	1920	1921	1922	1923	1924	1925
General Index	100	105	80	98	120	108	116
Pig Iron	100	119	55	88	131	102	119
Steel Ingots	100	121	57	102	129	109	131
Cotton Textiles	100	98	92	103	110	93	108
Wool Textiles	100	89	98	98	110	95	94
Wheat Flour	100	84	92	95	96	101	95
Animals Slaughtered:							
Cattle	100	86	76	86	91	95	98
Calves	100	103	97	106	114	126	137
Sheep	100	86	103	87	92	95	96
Hogs	100	91	95	106	131	127	104
Lumber	100	101	75	102	124	118	124
Copper	100	105	39	82	122	131	139

[a]Source: National Industrial Conference Board, Inc., Industrial-Economic Conditions in the United States, Bulletin No. 17 (New York, 1927), 9.

[6]Paul W. McCracken, The Northwest in Two Wars, Federal Reserve Bank of Minneapolis (Minneapolis, n.d.), 2-3. Cited hereafter as McCracken, Northwest in Two Wars.

TABLE 2

PHYSICAL PRODUCTION INDEX FOR AGRICULTURAL PRODUCTS IN THE UNITED STATES (1929=100)[a]

Year	Index
1919	86.1
1920	90.1
1921	82.1
1922	91.0
1923	94.0
1924	96.0
1925	96.0
1926	101.0

[a]Source: The Brookings Institution, The Recovery Problem in the United States, The Institute of Economics of the Brookings Institution publication no. 72 (Washington, D. C., 1936), 628.

Immediately following the end of the First World War, the accumulated demand for goods led to a period of intense spending and business prosperity in the United States. It was a period characterized by an "unprecedented orgy of extravagance, a mania for speculation, over-extended business in nearly all lines and in every section of the country, and general demoralization of the agencies of production and distribution."[7] A Congressional investigating commission in 1921 described these years as "a period of expansion, extravagance, and speculation, the like of which has never before been seen in this country or perhaps in the world."[8] In 1920 a precipitous decline in prices took place. In the United States the decline involved every class of industry and people.[9]

[7]Board of Governors of the Federal Reserve System, Annual Report of the Board of Governors of the Federal Reserve System, December 31, 1921, 1. Cited hereafter as Annual Report of the Federal Reserve Board, 1921.

[8]U. S. Congress, Agricultural Inquiry, II, 12-13.

[9]U. S. Congress, Agricultural Inquiry, I, 13.

The tide of optimism and expansion quickly turned to one of deflation and depression. Agricultural prices declined sharply as European export demand declined.

The year 1922 in the United States was a period of continuous economic recovery from the 1920 price decline. The latter half of 1921 was a period of relative price stability and this factor encouraged the expansion of business operations. In addition, agricultural conditions improved although agricultural prices remained out of line with those of industry.[10]

In the spring of 1923 a slight recession took place in business activity and continued until the middle of the following year. In agricultural areas, farm income was as large as it was in 1923 and the result was an improvement in the relative position of the farmer. This readjustment between the levels of industrial and farm prices was an important factor in the restoration of business prosperity later in the year.[11] Throughout the 1924-1926 period, economic conditions continued to improve. In 1926, industrial output exceeded previous levels and wage payments and employment were high. Generally, agriculture enjoyed large crop yields.[12]

Banking operations during the period following the turn of the century were closely related to economic conditions. Rising prices in the two decades following 1900 allowed profitable banking operations in spite of many slipshod practices.[13] The widespread

[10]Annual Report of the Federal Reserve Board, 1922, 1.

[11]Annual Report of the Federal Reserve Board, 1924, 1.

[12]Annual Report of the Federal Reserve Board, 1926, 1.

[13]Ibid., 13.

prosperity and rising prices that occurred during the First World War were regarded as a normal situation.[14]

During the war the banking system facilitated the mobilization of the industrial and financial resources of the nation through its credit expansion. Bank credit made possible the purchase of large quantities of government bonds as well as the capital necessary for the productive expansion of industry. During this period the Federal Reserve System regulated its policy to meet the needs of the Treasury Department. The success of the Victory Loan in May, 1919, depended upon a continuation of this easy credit policy. It was not until the rapid expansion was well under way that the Federal Reserve System adopted policies to tighten the availability of credit. The result of the easy credit policy was the extension by commercial banks of large amounts of credit based on the inflated commodity and land values of the period. Funds were loaned for land speculation and industrial expansion and excess credit lines became common.[15] In 1920 this expansion was sharply curtailed. As prices and values declined banks were unable to liquidate loans to meet heavy deposit withdrawals and other financial strains. The results were disastrous.

These conditions were particularly true in Montana where rapid growth had pushed land values to new high levels. The population of Montana had expanded rapidly after the turn of the century.

[14] C. D. Bremer, American Bank Failures (New York, 1935), 38. Cited hereafter as Bremer, Bank Failures.

[15] American Bankers Association, Present Day Banking (New York, 1936), 218. Cited hereafter as Bankers Association, Present Day Banking.

Between 1900 and 1920, the population more than doubled. This rapid increase of settlers was encouraged by the liberal provisions of the Homestead Acts of 1909 and 1912. Land grant size was increased from 160 to 320 acres and the proving-up time was decreased from 5 to 3 years. Under these conditions a 320 acre plot of land could be settled for less than 50 dollars.[16]

With the rapid increase in population came an increase in land values. Land that was valued at $250 million in 1910, by 1918 was worth twice that amount.[17] Wheat prices soared and optimistic farmers and bankers expected it to go even higher. Farmers borrowed to expand their operations at the inflated land values and bankers prospered as values continued to increase.

Such conditions could not continue indefinitely. In 1919, a period of drought overtook Montana. In 1920, severe winds swept away the plowed top soil and added to the agricultural misery. The drought continued into 1921 as falling farm prices aggravated an already severe situation. Farmers tried to withhold their products from the market but were eventually forced to sell at rapidly declining prices. Mortgage foreclosures increased rapidly and between 1919 and 1925 the number reached 20,000 in the state. This tragic number represents the bulk of the farm foreclosures in the history of the state.[18]

[16]Clarence W. Groth, "Montana Banking History," (unpublished thesis, School of Banking, Rutgers University), 40. Cited hereafter as Groth, "Montana Banking History."

[17]K. Ross Toole, Montana: An Uncommon Land (Norman, 1959), 235. Cited hereafter as Toole, Uncommon Land.

[18]Ibid., 238.

Montana banks generally were small institutions serving a small local area. Assets were largely confined to local loans and lacked the diversification necessary for financial strength. With the severe strain of the early 1920's, a majority of these banks (54 percent) were unable to continue operations. The widespread bank failures that took place added to Montana's grave economic distress.

The Superintendent of Banks in Montana described the history of the period as a reading of "Jeremiah's Book of Lamentations" and an "Egyptian famine." The 1920-1924 period was "one long dripping tunnel--a veritable nightmare" in which each new day brought new disasters. Of the 277 state banks reporting in 1921 to his office, 85 held less than the required legal reserve and 181 had not been examined by the Banking Department within the period required by law. The examinations that were conducted revealed banks full of "second mortgages, frozen assets, land contracts, commission notes and whatnot."[19] It is with this understanding of the economic background of the period that attention is turned to another important aspect of the setting for Montana bank failures--the legal framework within which banks operated during this period.

Since the founding of the American colonies, government has pursued an active and continually expanding role in the regulation of economic life. Within the complex economic organization

[19] Annual Report of the Banking Department, State of Montana for the fiscal year ending June 30, 1924, 12. Cited hereafter as Annual Report of the Banking Department, 1924.

that evolved the banking system occupied a central position; banks became a fundamental factor in economic growth and prosperity. Because of its quasi-public position, banking required governmental supervision which, by 1920, was a complex and sophisticated regulatory system.

Divided government control further complicated the system of bank regulation. The nation's banks were subject to regulation by forty-eight state governments as well as the Federal government. Within this complex system of regulation, jurisdictional problems often developed. Banks were frequently subject to the regulation of several governmental agencies. Often, as in Montana, there was a striking similarity between Federal and state requirements. However, Federal supervision generally entailed more restrictive requirements than the state banking codes.

The Federal government took several early steps toward strengthening the banking system. In 1864 a step was taken toward uniform direction and control of banking by the Federal government when the Banking Act was passed. This act provided the legal framework of a national banking system. Primary responsibility for the supervision of the national banks to be chartered under this act was given to the Bureau of the Comptroller of the Currency. Restrictions were imposed on the organization, note issue and required reserves of national banks. Several changes were made in these laws in the following years. A major revision of the laws regulating national banks took place in 1913 with the passage of the Federal Reserve Act.

By 1920, Federal regulation of national banks had developed into a complex legal framework. Organization and liquidation was under the direction of the Comptroller of the Currency. Capital requirements were set at $200,000 for banks located in cities with more than 50,000 inhabitants; $100,000 for cities between 6,000 and 50,000; $50,000 for cities from 3,000 to 6,000; $25,000 for cities of less than 3,000 inhabitants. Reserve requirements for demand deposits were set at 13 percent for central reserve city banks, 10 percent for reserve city banks, and 7 percent for other national banks. Time deposits required a reserve of 3 percent. These reserves were to be deposited with the Federal Reserve bank and cash on hand could not be included as a part of the required reserve. Stockholders were liable for the debts of the bank to the extent of the par value of their shares in addition to the amount invested in them. In addition, numerous limitations were placed on other aspects of the banks operations. Loans to any individual, partnership or corporation were limited in amount to 10 percent of the paid-in capital and surplus. Loans could not be made using the bank's shares as collateral. The Comptroller of the Currency conducted at least two examinations annually of each bank. A minimum of five financial reports were required each year. In addition, special reports could be requested whenever it was deemed necessary.

The scope of national bank operations was expanded considerably by the Federal Reserve Act. Former restrictions had placed national banks at a competitive disadvantage with state banks.

Many of these restrictions were removed by the Federal Reserve Act. National banks were granted fiduciary powers in areas where state banks enjoyed this privilege. The reduction of reserve requirements and the privilege of extending real estate loans opened the profitable savings business to national banks. Loans were permitted on unencumbered, improved farm land. These loans could not exceed 50 percent of the market value of the property and were limited to a maximum period of five years. The total amount of such loans could not exceed 25 percent of the lending bank's capital and surplus or one-third of its time deposits. Loans on improved urban property were permitted for a maximum maturity of one year. These restrictions were only a few of the many regulations applied to national bank operations.[20]

Another important governmental agency was created by the Federal Reserve Act. The Federal Reserve System was established to provide the nation with an elastic currency, discounting facilities and improved banking supervision. Membership was required for all national banks while participation was optional for state banks. Important changes were made to the original bill in the following years. After the crisis of 1920, farm groups were successful in obtaining several changes in the law. An amendment in 1922 provided for a representative of agriculture on the Federal Reserve Board. Concessions were made in 1923 when the capital requirements for membership of state banks were lowered by 60 percent. In

[20]U.S., Statutes at Large, XXXVIII-XLI, Title 12 passim.

addition, Federal Reserve banks were allowed to discount or purchase certain agricultural sight drafts, acceptances, and agricultural paper.[21]

Membership in the Federal Reserve System involved certain obligations. Generally these requirements were similar to those prescribed for national banks. In addition to meeting these requirements, member banks enjoyed the use of the loan and rediscounting as well we the check collecting facilities of the Federal Reserve System.

By 1920, the number of state banks considerably exceeded the number of national banks. These banks were subject to the supervision of state officials. In Montana the first banking laws were enacted in 1887, prior to statehood. During the following years these banking laws were improved and expanded. In 1915, extensive revisions were made to the banking code. It was generally within this legal framework of 1915 that the state banks of Montana operated during the 1920-1926 period.

The Banking Department was established to exercise governmental supervision over state banks and was placed under the direction of the Superintendent of Banks. The State Examiner became ex-officio Superintendent of Banks and was appointed to a four year term by the governor. The Superintendent was primarily concerned with the financial condition of state banks and to insure observation of state banking laws. In order to determine the

[21]Fredrick A. Bradford, Banking (New York, 1932), 75-124 passim. Cited hereafter as Bradford, Banking.

financial condition of state banks, the Superintendent required five regular financial reports each year. In addition to these, special reports could be requested when deemed necessary. At least two bank examinations were required each year to provide a verification of the bank's financial condition. In these audits, examiners concerned themselves with the bank's observation of sound banking principles as well as their compliance with legal requirements.

By 1920, state banks were subject to a considerable number of state requirements. Operations could begin and end only with the approval of the Banking Department. A minimum of $20,000 was set for bank capital. Stockholders were liable for bank debts to the extent of the par value of their shares in addition to the amount invested in them. Real estate loans were generally restricted to first liens and a maximum loan amount was set at 50 percent of the property's market value. A maximum of 35 percent of the bank's assets could be in this form. Loand to any individual, partnership or corporation could not exceed 20 percent of the capital and surplus of the bank. Reserve requirements were set at 10 percent of deposits, a portion of which could be deposited with reserve banks approved by the Superintendent. Reserve banks were required to maintain a 15 percent reserve in a similar manner. These requirements, in many respects, were similar to those for national banks.[22]

Other governmental authorities, to a lesser extent, influenced the operation of the banking system. By 1920 these governmental

[22]Montana, Revised Statutes (1921), c. 13, secs. 6014-6109.

relationships had become an important characteristic of the banking system. It is in this light that these relationships become an important part of the bank failure pattern of the early 1920's.

Economic conditions and governmental regulations were important factors in the setting of Montana bank failures. It is with this understanding that the following chapter turns to a detailed examination of the bank failure pattern.

CHAPTER II

THE PATTERN OF BANK FAILURES

The widespread wave of bank failures during the early 1920's revealed several basic weaknesses in the banking system. The economic readjustment that followed the end of World War I brought a sharp decline in the prices of agricultural products. Farmers faced a rapidly decreasing income while the price of needed supplies continued to increase. Faced with high fixed mortgage payments and rising costs, the farmers turned to local banks for credit. Small unit banks in rural agricultural areas were soon overburdened with past due and uncollectable loans. A widespread wave of bank failures reflected this financial distress. A large percentage of the nation's banks failed; others continued operations throughout the 1920-1926 period. In several important respects, common characteristics can be distinguished between these failing and non-failing banks. Such a failure pattern becomes an important consideration in understanding the bank failures of this period.[1]

An important aspect of bank operations was the supervising authority of governmental agencies. A noted difference existed between the failure of nationally and state chartered banks. For the United States as a whole, state banks failed twice as often as national banks. The average yearly suspension of total active

[1]The classification of failing banks, except in Tables 1-4, includes state banks that suspended operations between Nov. 15, 1920, and June 30, 1926. National banks are included as failing that closed between Sept. 8, 1920 and Dec. 31, 1926, and did not reopen.

commercial banks for the 1921-1925 period was 1.06 percent for national banks and 2.17 percent for state banks. Although these differences varied from year to year, the percentage of state bank failures was higher than those for national banks throughout the period. Table 3 illustrates this yearly difference.

TABLE 3

PERCENT OF SUSPENDING BANKS TO TOTAL ACTIVE COMMERCIAL BANKS BY TYPE OF BANK IN THE UNITED STATES [a]

Year	National	State	Ratio State to Nat'l
1921	.64%	1.83%	2.86
1922	.59	1.34	2.27
1923	1.09	2.47	2.26
1924	1.50	2.95	1.97
1925	1.46	2.26	1.55

[a]Calculated from: All-Bank Statistics; United States 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 41, 45, and Banking and Monetary Statistics, Board of Governors of the Federal Reserve System (Washington, D. C., 1943), 283.

In Montana there were important differences from these national averages. A higher percentage of both national and state banks failed in Montana than the average for the United States. The average yearly suspension of active Montana commercial banks was 10.1 percent for national banks and 12.2 percent for state banks. The average yearly suspensions for this 5 year period in Montana exceeded the United States average by 9.5 times for national banks and 5.6 times for state banks. However, the ratio between state and national bank failures in Montana was much less than for the nation as a whole. These yearly differences are shown in the following table.

TABLE 4

PERCENT OF SUSPENDING BANKS TO TOTAL ACTIVE COMMERCIAL BANKS BY TYPE OF BANK IN MONTANA [a]

Year	National	State	Ratio State to Nat'l
1921	4.9%	5.4%	1.10
1922	6.8	8.2	1.21
1923	14.0	24.8	1.77
1924	14.0	18.1	1.29
1925	10.6	4.7	.44

[a]Calculated from: All-Bank Statistics; United States 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 609, 613, and Banking and Monetary Statistics, Board of Governors of the Federal Reserve System (Washington, D. C., 1943), 90, 188, 286.

The comparison of national and state bank failures is even more striking when bank deposits are examined. Deposits of suspending state banks averaged 2.87 times higher than for suspending national banks for the 5 year period. The yearly percentages in the following table show this variation.

TABLE 5

PERCENT OF DEPOSITS IN SUSPENDING BANKS TO TOTAL ACTIVE COMMERCIAL BANK DEPOSITS BY TYPE OF BANK IN THE UNITED STATES [a]

Year	National	State	Ratio State to Nat'l
1921	.14%	.78%	5.57
1922	.12	.36	3.00
1923	.20	.53	2.65
1924	.35	.60	1.71
1925	.28	.41	1.46

[a]Calculated from: All-Bank Statistics; United States 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 44, and Banking and Monetary Statistics, Board of Governors of the Federal Reserve System (Washington, D. C., 1943), 20-21, 283.

In Montana the percentage of suspended deposits to total deposits was much higher than the nation-wide average. National and state banks in the United States averaged deposit suspensions of .22 percent and .58 percent of their deposits respectively for the 1921-1925 period. In Montana national bank deposit suspensions averaged 4.8 percent while those for state banks averaged 8.3 percent during this period. The ratio of state bank deposit suspensions to national bank suspensions was much less than the nation-wide average. In Montana state bank deposit suspensions averaged 1.77 times those of national banks during the 1921-1925 period. This stands in sharp contrast to the nation-wide average for state bank deposit suspensions of 2.88 times those of national banks. Table 6 illustrates the yearly percentages for Montana.

TABLE 6

PERCENT OF DEPOSITS IN SUSPENDING BANKS TO TOTAL ACTIVE COMMERCIAL BANK DEPOSITS BY TYPE OF BANK IN MONTANA [a]

Year	National	State	Ratio State to Nat'l
1921	1.9%	6.4%	3.37
1922	4.1	5.6	1.37
1923	8.9	18.6	2.09
1924	6.8	9.3	1.37
1925	2.1	1.4	.66

[a]Calculated from: All-Bank Statistics; United States 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 608, 612, and Banking and Monetary Statistics, Board of Governors of the Federal Reserve System (Washington, D. C., 1943), 287, 289, 291.

The Federal Reserve System prescribed certain requirements for national and state member banks. One of the objectives of the

System was to bring financial stability to the banking system as a whole. In the United States during the early 1920's, non-member banks generally failed twice as often as Federal Reserve member banks.[2] This difference was less distinct in Montana. An examination of Montana banks in 1920 shows that 51 percent of member and 57 percent of non-member banks filed by the end of the period. These differences are illustrated by the following table.

TABLE 7

COMPARISON OF THE FAILURE OF FEDERAL RESERVE MEMBER BANKS AND NON-MEMBER BANKS IN MONTANA [a]

	Member		Non-Member	
Banks	Number	Percent	Number	Percent
Failing	100	51%	114	57%
Non-Failing	96	49	86	43
Total	196	100	200	100

[a] Calculated from: statements contained in the Annual Reports of the Montana Banking Department between Nov. 15, 1920, and June 30, 1926, and from statements in the Annual Reports of the Comptroller of the Currency between Sept. 8, 1920, and Dec. 31, 1926. Membership is based on membership of state banks on Nov. 15, 1920, and of national banks on Sept. 8, 1920.

Bank size was another important part of the failure pattern. Failing banks generally were smaller institutions than non-failing banks. The average capitalizations of failing national and state banks in Montana were $47,770 and $35,928 respectively. These averages for non-failing banks were $68,676 and $47,456 respectively.

[2] See statistics in Banking and Monetary Statistics, Board of Governors of the Federal Reserve System (Washington, D. C., 1943), 21-22, 283.

Numerous exceptions existed to this general rule. Individual large banks as well as small banks failed. However, larger banks were able to withstand the financial pressures of the early 1920's better than the smaller, less diversified banks. The following table classifies Montana commercial banks by the amount of capitalization.

TABLE 8

NUMBER AND PERCENT OF FAILING AND NON-FAILING BANKS IN MONTANA CLASSIFIED BY CAPITALIZATION [a]

Capital	Failing		Non-Failing	
	Number	Percent	Number	Percent
-$20,000	63	29.5%	35	19.2%
20,001- 30,000	95	44.4	72	39.6
30,001- 50,000	31	14.5	33	18.1
50,001-100,000	15	7.0	24	13.2
100,001-200,000	8	3.7	12	6.6
200,001-500,000	2	.9	6	3.3
Total	214	100.0	182	100.0

[a]Calculated from: statements contained in the Annual Reports of the Montana Banking Department between Nov. 15, 1920, and June 30, 1926, and from statements in the Annual Reports of the Comptroller of the Currency between Sept. 8, 1920, and Dec. 31, 1926. Capitalization amount for national banks is as of Sept. 8, 1920, and for state banks as of Nov. 15, 1920.

Capitalization is only one method of indicating the size of a bank. When considered as an isolated factor in determining bank size it may be misleading. In addition to capitalization, other factors should be considered. Another means of comparing the relative size of banks is by comparing total resources. The averages of total resources for failing national and state banks in Montana were $319,411 and $562,527 respectively. These averages for non-failing national and state banks were $495,813 and $982,787

respectively. These averages and the classification of banks by total resources in Table 9 show that banks with small resources failed more often than banks with larger total resources.

TABLE 9

NUMBER AND PERCENT OF FAILING AND NON-FAILING BANKS IN MONTANA CLASSIFIED BY TOTAL RESOURCES [a]

Total Resources	Failing		Non-Failing	
	Number	Percent	Number	Percent
- $100,000	23	10.7%	12	6.6%
100,001- 250,000	96	44.9	73	40.1
250,001- 500,000	59	27.6	40	22.0
500,001- 1,000,000	17	7.9	31	17.0
1,000,001- 2,500,000	13	6.1	13	7.1
2,500,001- 5,000,000	6	2.8	11	6.1
5,000,001-	..	...	2	1.1
Total	214	100.0	182	100.0

[a] Calculated from: statements contained in the Annual Reports of the Montana Banking Department between Nov. 15, 1920, and June 30, 1926, and from statements in the Annual Reports of the Comptroller of the Currency between Sept. 8, 1920, and Dec. 31, 1926. Total resources for national banks are as of Sept. 8, 1920, and for state banks as of Nov. 15, 1920.

Another useful measure of bank size is the amount of total time and demand deposits. The average total deposits in failing Montana national and state banks were $355,949 and $204,965 respectively. These averages for non-failing national and state banks for the 5 year period were $691,555 and $369,138 respectively. Failing banks generally were smaller than non-failing banks whether measured by capitalization, total resources, or deposits. A comparison of failing and non-failing bank deposits in Montana is contained in the following table.

TABLE 10

NUMBER AND PERCENT OF FAILING AND NON-FAILING BANKS IN MONTANA CLASSIFIED BY DEPOSITS[a]

Deposits[b]	Failing		Non-Failing	
	Number	Percent	Number	Percent
- $75,000	50	23.4%	18	9.9%
75,001- 150,000	58	27.1	56	30.8
150,001- 350,000	72	33.6	55	30.2
350,001- 600,000	13	6.1	23	12.6
600,001-1,000,000	12	5.6	8	4.4
1,000,001-2,500,000	8	3.7	15	8.2
2,500,001-5,000,000	1	.5	5	2.8
5,000,001-	..	...	2	1.1
Total	214	100.0	182	100.0

[a]Calculated from: statements contained in the Annual Reports of the Montana Banking Department between Nov. 15, 1920, and June 30, 1926, and from statements in the Annual Reports of the Comptroller of the Currency between Sept. 8, 1920, and Dec. 31, 1926.

[b]Includes time and demand deposits on Nov. 15, 1920, for state banks and on Sept. 8, 1920, for national banks.

Since a bank primarily serves its local area, the location of failing and non-failing banks is an important part of the failure pattern. Failures west of the Continental Divide in Montana were a smaller percentage of the area's active commercial banks than in the remainder of the state. This East-West distribution of failures is illustrated by Table 11.

Generally, failing banks were located in smaller communities than non-failing banks. This factor and the East-West distribution of bank failures suggests the rural, agricultural influence upon the failure pattern. Nearly 58 percent of the bank failures in Montana occurred in communities of less than 500 population. For the United

States as a whole, 34.9 percent of failures were in communities with less than 500 population.[3] Failures in Montana communities of less than 2,000 persons included 85 percent of the state's bank failures. Table 12 illustrates the failure pattern by the size of the community.

TABLE 11

NUMBER AND PERCENT OF FAILING AND NON-FAILING BANKS IN MONTANA CLASSIFIED BY LOCATION[a]

Banks	East		West[b]	
	Number	Percent	Number	Percent
Failing	194	56.4%	20	38.5%
Non-Failing	150	43.6	32	61.5
Total	344	100.0	52	100.0

[a]Calculated from the location of failing banks indicated in statements in the Annual Reports of the Montana Banking Department between Nov. 15, 1920, and June 20, 1926, and from statements in the Annual Reports of the Comptroller of the Currency between Sept. 8, 1920, and Dec. 31, 1926.

[b]Includes areas west of the Continental Divide in Montana.

TABLE 12

NUMBER AND PERCENT OF FAILING AND NON-FAILING BANKS IN MONTANA CLASSIFIED BY SIZE OF COMMUNITY[a]

Community Population[b]	Failing		Non-Failing	
	Number	Percent	Number	Percent
300	90	42.0	50	27.5
301- 500	34	15.9	25	13.7
501- 1,000	31	14.5	35	19.2
1,001- 2,000	27	12.6	27	14.8
2,001- 3,000	11	5.1	8	4.4
3,001- 5,000	..	...	9	5.0
5,001-10,000	12	5.6	9	5.0
10,001-20,000	4	1.9	12	6.6
20,001-	5	2.4	7	3.8
Total	214	100.0	182	100.0

[a]Calculated from the location of failing banks indicated by statements in the Annual Report of the Banking Department in Montana between Nov. 15, 1920, and June 30, 1926, and from statements in the Annual Report of the Comptroller of the Currency between Sept. 8, 1920, and Dec. 31, 1926.

[b]Based on population in 1920.

[3]Bremer, Bank Failures, 48.

A useful comparison of failing and non-failing banks is one that examines the length of bank life prior to failure. This comparison shows the extent that banks had become an accepted and long-standing part of the community. In Table 13 banks are arranged into categories by the date of their incorporation. Of the failing banks, 79 percent were incorporated after 1910; 68 percent of the non-failing banks were incorporated during the same period. From this comparison it is evident that failing banks were not as well established and were newer institutions than non-failing banks.

TABLE 13

NUMBER AND PERCENT OF FAILING AND NON-FAILING BANKS IN MONTANA CLASSIFIED BY LENGTH OF LIFE PRIOR TO 1920[a]

Incorporation Date	Failing		Non-Failing	
	Number	Percent	Number	Percent
1918 - 1920	31	15	14	8
1915 - 1917	67	30	55	30
1910 - 1914	73	34	54	30
1905 - 1909	30	14	28	15
1900 - 1904	7	4	13	7
- 1899	6	3	18	9
Total	214	100	182	100

[a]Source: Calculated from: Statements contained in the Annual Report of the Banking Department between Nov. 15, 1920, and June 30, 1926, and from statements in the Annual Report of the Comptroller of the Currency between Sept. 8, 1920, and Dec. 31, 1926.

The bank failures in Montana during the 1920-1926 period were primarily a rural, small bank phenomena. Closely tied to the local economy, small rural banks often were unable to withstand the crisis created by sharply declining agricultural prices. The widespread wave of bank failures demonstrated the basic weaknesses of the nation's small unit banking system. Among these weaknesses several major

problems are apparent. These aspects of the banking system--regulatory authority, agricultural factors, financial strength, and bank size--merit further examination in the following chapters.

CHAPTER III

THE ROLE OF GOVERNMENTAL AUTHORITIES

The legal framework of banking laws and regulations was an important part of the bank failure pattern of the early 1920's. State banks generally failed more often than national banks in the United States. This variation can be partially explained by the higher standards required for national bank charters. The result of this stricter policy was that national banks generally were stronger and more diversified institutions than most state banks. In Montana the difference between state and national bank regulations was less than in many states. As a result, the difference was not as great between the individual banks and their failure rates. Comparisons between Federal Reserve member and non-member state banks reflect this same relationship.

Generally, the influence of governmental policy upon the operations of individual banks was indirect and should not be overemphasized. Government regulation and supervision could not insure, in itself, a sound banking policy. It could only assist in attaining that end.[1] General responsibility for the operation of a bank rests with its management. Since the test of effective management

[1] R. F. Leonard, "Supervision of the Commercial Banking System," Banking Studies, Board of Governors of the Federal Reserve System (Baltimore, 1941), 192.

is the ability to resolve unforeseen difficulties,[2] the responsibility for a bank's failure rests with its management and generally cannot be shifted to others.[1]

What, then, was the relationship of government actions during the 1920-1926 period to the widespread wave of bank failures? In answering this question, primary concern is directed toward those agencies that directly supervised the operations of commercial banks--the state Banking Department in Montana, the Comptroller of the Currency, and the Federal Reserve System.

The banking system, as a whole, has suffered from the division of governmental supervision. The existence of different systems of governmental supervision has encouraged competition between governmental agencies to extend their influence and jurisdiction. This competition was responsible for many of the problems that faced banks during the early 1920's. The unit banking system that developed in the United States was a natural outgrowth of this divided jurisdiction. States-rights became an effective barrier against a more uniform system.[3] The result was a competitive lowering of banking restrictions and a situation that made reform difficult.[4] The ability of individual banks to shift from one system to the other made authorities reluctant to strengthen banking requirements or to strictly enforce their provisions.

[2]Bremer, Bank Failures, 99.

[3]Ibid., 95.

[4]Thomas Joel Anderson, Federal and State Control of Banking (New York, 1934), 3, 5, 304. Cited hereafter as Anderson, Control of Banking.

Governmental competition was reflected in the chartering of banks. Charters often were granted to banks that would compete with those operating under another governmental authority where the need for such additional services did not exist. The inevitable result was an excessive number of banks. By 1921 the number of banks in the United States reached an all-time high of nearly 23,000 state and 8,000 national banks.[5] Bitter competition developed between banks for the available business. This excessive chartering of banks was a fundamental cause of the bank failures in the early 1920's.[6] States where the number of banks to population was high, without exception, suffered high bank failure rates.[7] This relationship is illustrated by the experience of New Jersey where a strict charter policy prevailed and where bank failure were negligible.[8]

The bank failure pattern in the Ninth Federal Reserve District reflected this overbanked condition. Credit competition often resulted in questionable loans made by banks--"loans which often broke the banks and debtors alike."[9] Tables 14 and 15 illustrate that Montana was no exception to this general pattern. Between 1910 and 1920 there were 397 bank charters granted in Montana. In

[5]Bankers Association, Present Day Banking, 196-97.

[6]Annual Report of the Comptroller of the Currency for the Year Ending December 31, 1925, 5. Cited hereafter as Annual Report of the Comptroller of the Currency, 1925.

[7]Bankers Association, Present Day Banking, 215.

[8]Virgil Willit, Chain, Group and Branch Banking (New York, 1930, 126. Cited hereafter as Willit, Banking.

[9]McCracken, Northwest in Two Wars, 17.

1917 a high point was reached when 82 charters were approved.[10] Between 1911 and 1920 the total number of banks increased from 175 to 431 in Montana. By 1930 this total had declined to its 1911 level.[11] The fact that many of the charters issued were never used indicates a careless charter policy. Obtaining a charter often became a speculative undertaking in anticipation of a profitable opportunity. If the opportunity failed to materialize, the charter simply was not used.[12] Chartering officials generally shared the optimism of the period and felt that rapid growth would quickly justify their liberal charter policy.[13]

TABLE 14

NUMBER OF PEOPLE PER BANK FOR 1909 AND 1921 BY STATE[a]

State	Population per Bank 1909	1921
Michigan	4,670	5,130
Wisconsin	3,920	2,710
Minnesota	2,390	1,590
MONTANA	2,920	1,370
South Dakota	946	921
North Dakota	899	768
United States[b]	3,950	3,520

[a]Source: Curtis L. Mosher, The Causes of Banking Failure in the Northwestern States (Minneapolis, 1930), 28.

[b]Excludes island possessions.

[10]Groth, "Montana Banking History," 43.

[11]Curtis L. Mosher, The Causes of Banking Failure in the Northwestern States (Minneapolis, 1930), 8. Cited hereafter as Mosher, Causes of Failure.

[12]Groth, "Montana Banking History," 44-45.

[13]Mosher, Causes of Failure, 6-7.

By failing to insist on proper banking standards, the Banking Department in Montana and the Comptroller of the Currency indirectly contributed to a weak banking system.[14] Frequent attempts were made to liberalize national bank requirements. In 1900 the minimum capital requirement for national banks was reduced from $50,000 to a $25,000 minimum. The restriction on the amount of national bank notes that could be issued was changed from 90 percent to 100 percent of the value of bonds deposited to secure their issue. In 1906 the restrictions on total loans to any one individual, firm or corporation by an individual bank were changed from 10 percent of capital to 10 percent of capital and surplus.[15] These were only a few of the changes made to liberalize banking requirements. Since state requirements generally were more liberal than national bank requirements, the Comptroller of the Currency argued that national banks operated under a competitive disadvantage. His annual reports for the early 1920's asked that the two types of banks be placed on an equal footing.[16]

TABLE 15

NUMBER OF BANKS TO POPULATION FOR SELECTED STATES IN 1920[a]

State	No. of Banks	Population	Average No. People per Bank
Minnesota	1,515	2,387,000	1,600
MONTANA	431	549,000	1,300
North Dakota	898	647,000	700
South Dakota	694	637,000	900
New York	1,056	10,385,000	9,800
Pennsylvania	1,546	8,720,000	5,700
Massachusetts	465	3,852,000	8,300

[a]Source: Paul W. McCracken, The Northwest in Two Wars, Federal Reserve Bank of Minneapolis (Minneapolis, n.d.), 16.

[14]Bremer, Bank Failures, 110.

[15]Anderson, Control of Banking, 316.

[16]Annual Report of the Comptroller of the Currency, 1921, 4.

State banking officials and the Comptroller of the Currency contributed to the collapse of the early 1920's by continually lowering banking standards and by the granting of an excessive number of bank charters. The excessive number of banks in Montana during this period was an important factor in the inability of the banking system to withstand the crisis during the 1920-1926 period.

Government supervision of banking was extended in 1913 by the establishment of the Federal Reserve System. Its objectives included the establishment of a flexible note supply based on self-liquidating commercial paper and the establishment of a source of emergency credit for banks in times of financial stress.[17] The System was not established to prevent bank failures although its functions contributed to a strengthening of the banking system. The System could not assure good bank management or make a bank's operations automatically successful.[18]

At the time of its establishment, central banking experience was nonexistent and the role of the Federal Reserve System was not clearly defined. Early Federal Reserve officials were commercial bankers and lacked a clear understanding of the functions of a central bank.[19] In addition, the accepted theory of business cycles affected Federal Reserve actions. Federal Reserve officials viewed periods of

[17]Bradford, Banking, 446.

[18]Charles Wallace Collins, Rural Banking Reform (New York, 1931), 41-42.

[19]Letter of Clement Van Nice to John H. Toole, Dec. 8, 1966. (Copy in the possession of Dr. K. Ross Toole, Department of History, University of Montana.) Cited hereafter as Letter of Clement Van Nice to John H. Toole, Dec. 8, 1966.

boom and rapid expansion as the inevitable result of excessive credit expansion. Depression was the inevitable result of such an inflationary boom. If credit was restricted to its proper role of financing the production and distribution of goods, inflation and depression would be prevented. The use of credit for such speculative ventures as withholding products from the market in anticipation of a price increase was regarded as improper. Indeed, Federal Reserve officials viewed the post-war period of expansion as a period of credit misuse.[20]

Because of this theory, the Federal Reserve System viewed its role as one of assisting in the "orderly liquidation" that would follow the inflationary period. Liquidation was regarded as necessary for economic recovery. The proper role of the Federal Reserve System was a passive one that would facilitate the liquidation process. Actions to stimulate recovery were regarded as artificial and even as superficial. High rediscount rates were necessary to assist the liquidation of credit excesses accumulated during the preceding boom period and to discourage nonessential credit expansion. It was believed that only in this way could a sound recovery be realized. The influence of these ideas on the actions of the Federal Reserve System during the early 1920's is apparent when the events of this period are examined.

During the First World War the government encouraged rapid productive expansion; Federal Reserve policy during this period generally followed the needs of the government. Bank credit expanded rapidly to encourage rapid industrial expansion and to finance

[20]Clay J. Anderson, A Half-Century of Federal Reserve Policymaking, 1914-1964, Federal Reserve Bank of Philadelphia (Philadelphia, 1965), 16-34 passim. Cited hereafter as Anderson, Federal Reserve Policymaking.

large government expenditures. Rediscount rates were set at artificially low levels and preferential rates were allowed on government securities. By the spring of 1919 the Treasury Department had floated loans totaling $21 billion at interest rates below the market levels.[21] Such an undertaking would have been impossible without the cooperation of the Federal Reserve System. The extension of Federal Reserve credit in the form of loans, rediscounts and bills purchased increased between 1917 and 1918 by 1,487 percent. During the same period Federal Reserve notes increased 483 percent.[22]

Between 1918 and 1919, the Federal Reserve Board continued to follow the policy of the Treasury Department. The System tried to curb excessive credit expansion through appeals to member banks for the elimination of speculative and nonessential loans. The demand for additional collateral for rediscounts was an attempt to reduce member bank rediscounts by reducing their supply of eligible paper.[23] Such policies generally were unsuccessful in restricting the rapid credit expansion.[24] In May 1919 the Victory Loan was floated at 4 3/4 percent. It was not until this operation was complete that the Treasury Department felt secure enough to agree to any credit restriction by the Federal Reserve System. By this time the rapid economic expansion and inflation were well advanced.

Concern began to develop over rapidly increasing prices as inflationary pressures continued. Complaints were heard on all sides

[21]Bradford, Banking, 448.

[22]U. S. Congress, Agricultural Inquiry, II, 37.

[23]Anderson, Federal Reserve Policymaking, 21-22.

[24]U. S. Congress, Agricultural Inquiry, II, 44.

about the high cost of living. On May 17, 1920, the United States Senate adopted a resolution asking the Federal Reserve Board to report what actions had been taken to meet the inflationary threat. Newspapers joined the clamor for price reductions. This growing concern and the increasing exhaustion of credit resources produced a rapid change in the psychological attitude of the people. With the beginning of the price decline in 1920, optimism turned to timidity. Merchants cancelled orders and bankers began to contract their loans.[25] The entire process had a snowballing effect.

Free from the necessity to pattern actions by Treasury Department policy, the Federal Reserve System began to slowly tighten the supply of credit. In December 1919 rediscount rates were raised slightly and larger advances were made throughout the following year. Several Federal Reserve banks had reached 7 percent by midyear. Uniform rates were adopted and the differential on government securities was abolished. Rates were based on loan maturity regardless of the security pledged on the theory that member bank endorsement made all rediscounts theoretically sound. The elimination of preferential rates on government securities led to widespread selling of these securities as banks turned to investments with higher yields.[26] The large influx of government bonds onto the market caused the price to fall sharply.

The problem of Federal Reserve credit policy was complicated by the credit position of many banks. In 1920 roughly one-third of

[25] U. S. Congress, Agricultural Inquiry, II, 86.

[26] Ibid., 48.

the nation's banks were overextended, one-third were moderately extended and one-third were lending conservatively. The one-third that was overextended generally had reached the point where further borrowing would endanger their solvency. An easing of credit policy by the Federal Reserve System would encourage an expansion of loans. If loans were expanded during a period of rapidly declining prices the credit strain would become more pronounced and the possibility of bank failures would increase. A rediscount rate reduction of sufficient magnitude to arrest the process of liquidation seemed to be a real menace.[27] Because of this situation, the Federal Reserve System was reluctant to encourage an easy credit policy. The choice seemed to be one of high rediscount rates with the resulting hardships or lower rates and the possibility of a financial crisis. The first alternative was selected.

By September 1920, the general commodity price index fell from a peak of 272 to 242 and the agricultural products price index fell from 244 to 210. Strong sentiment developed that pointed to the high Federal Reserve rediscount rate as responsible for the sharp decline. The Federal Reserve System was accused of pursuing a conscious program of forced liquidation. This accusation was not true.[28]

In the Ninth Federal Reserve District between 1920 and 1921, a decrease of $64.4 million in the loans and discounts of member

[27]U. S. Congress, Agricultural Inquiry, II, 87-88.

[28]Anderson, Federal Reserve Policymaking, 26.

banks was matched by a decrease of only $12.6 million in the total amount borrowed from the Federal Reserve bank. In addition, the contention that Federal Reserve credit was withheld from agricultural areas was not true. While the loans and discounts of member banks in agricultural counties[29] were reduced by $19.1 million, the total borrowing from the Federal Reserve bank in the same counties increased by $18.3 million. For the nation as a whole, loans and discounts of member banks in agricultural counties were decreased by $36.5 million while borrowing from Federal Reserve banks increased by $127.6 million.[30] The contrast in liquidation illustrated in Table 16 shows that the most severe contraction took place in the non-agricultural counties.

TABLE 16

PERCENT OF INCREASE OR DECREASE IN BORROWING FROM[a] FEDERAL RESERVE BANKS BY MEMBER BANKS, 1920-1921

(Millions of Dollars)

Location	Loans and Discounts of Member Banks	Borrowing From Federal Res.[b]
Ninth District:		
Agricultural Counties	- 4.8	+102.2
Semiagricultural Counties	- 6.1	- 7.4
Nonagricultural Counties	-12.0	- 46.9
Total	- 8.0	- 14.3
United States:		
Agricultural Counties	- 1.2	+ 56.6
Semiagricultural Counties	- 1.3	- 0.2
Nonagricultural Counties	- 5.6	- 28.5
Total	- 4.5	- 19.5

[a]Source: U. S. Congress, Agricultural Inquiry, Hearing before the Joint Commission of Agricultural Inquiry, 67th Cong., 1st Sess., (Washington, 1922), II, 103.

[29]Counties where the value of agricultural production exceeds 80 percent of the value of total county production were classified as agricultural.

[30]U. S. Congress, Agricultural Inquiry, II, 103.

As the price decline of 1920 progressed, the loans of the Federal Reserve Bank of Minneapolis climbed steadily. By October 1920, they had reached an all-time high.[31] The Minneapolis Bank found it necessary to borrow from other Federal Reserve banks to meet the growing credit needs of the Ninth District. On January 1, 1921, its actual reserve was 39.2 percent. Without the funds borrowed from other Federal Reserve banks, this ratio would have been 29.7 percent.[32]

Between 1918 and 1920, farm mortgage loans in Montana increased from 7.6 percent of the total mortgage loans to 12.5 percent. During the same period personal and collateral loans to farmers increased from 38.96 percent to 47.72 percent of the total. These averages for the nation as a whole were 4.50 percent and 4.97 percent respectively for farm mortgage loans and 11.17 percent and 13.29 percent respectively for personal and collateral loans to farmers.[33] Between 1922 and 1925 the total decrease in the amount of agricultural loans within the Ninth District was only 3.6 percent of the total or 1.2 percent average each year.[34]

Between February 1, 1921, and August 31, 1921, the loans of the Federal Reserve Bank of Minneapolis increased from $7.6 million to $13.6 million in Montana. During 1921 the Helena Branch of the Minneapolis Bank loaned funds to 176 banks that totaled $32.7 million

[31] Mosher, Causes of Failure, 18.

[32] "Banking and Financial Notes," The Banker's Magazine, LII (February, 1921), 318.

[33] U. S. Congress, Agricultural Inquiry, II, 97-98.

[34] Mosher, Causes of Failure, 18.

in rediscounts and $25.2 million in collateral loans.[35] Table 17 illustrates the decrease of these amounts in the following years.

TABLE 17

REDISCOUNTS AND LOANS TO MEMBER BANKS IN MONTANA BY THE HELENA BRANCH OF THE FEDERAL RESERVE BANK OF MINNEAPOLIS BY YEAR[a]

Year	No. of Banks Served	Rediscounts		Loans	
		No.	Amount	No.	Amount
1922	165	13,777	$20,965.000	539	$7,405,000
1923	132	9,241	14,183,000	260	3,814,000
1924	102	4,763	5,622,000	84	1,851,000
1925	60	1,545	1,554,000	30	238,000
1926	48	1,507	1,055,000	63	1,053,000

[a]Source: Letter of Clement Van Nice to John H. Toole, Dec. 8, 1966.

The figures illustrated in Table 17 represent the new loans made and do not measure the length of loan maturity. A more meaningful measure of the amount of credit supplied to Montana banks on a continuous basis is indicated by the average amount of daily borrowing by member banks from the Helena Branch. The average amount of daily borrowing during this period was: $10,064,000 in 1921; $7,511,000 in 1922; $4,803,000 in 1923; $1,917,000 in 1924. Many banks were almost continuously indebted to the Federal Reserve bank throughout this period. Without the credit supplied by the Federal Reserve Bank of Minneapolis and the Twin City correspondent banks, a considerably larger number of banks would have been unable to withstand the financial crisis.[36]

[35]Letter of Clement Van Nice to John H. Toole, Dec. 8, 1966. See also Groth, "Montana Banking History," 61.

[36]Letter of Clement Van Nice to John H. Toole, Dec. 8, 1966.

An examination of the consolidated balance sheet for Montana state and national commercial banks on June 30, 1921, shows that many banks were overextended. Total deposits were only $2 million more than total loans; the ratio of loans to deposits was 98.6 percent. Borrowing equaled 20 percent of deposits and about one-half of the banks had total loans that exceeded the amount of their deposits. In some cases this excess was by a large margin.[37] The following condensed financial statement in Table 18 reveals this overextended position and shows why the Federal Reserve Bank of Minneapolis was reluctant to encourage further credit extensions by lowering the rediscount rate. Rather than forcing a radical liquidation, the Federal Reserve Bank of Minneapolis made it possible for many Montana banks to continue carrying large amounts of overdue paper.

TABLE 18

CONDENSED STATEMENT OF CONDITION (CONSOLIDATED)[a]
420 MONTANA BANKS
(143 NATIONAL - 277 STATE)
June 30, 1921

Assets		Liabilities	
Loans	$144,000,000	Deposits	$146,000,000
Investments	27,000,000	Borrowings	28,000,000
Cash	29,000,000	Nat'l Bank Notes	4,000,000
Other	10,000,000	Capital Accounts	31,500,000
		Other	500,000
Total	$210,000,000	Total	$210,000,000

[a]Source: Paper presented by Clement Van Nice and Dick Heiber before the joint meeting of the Board of Directors of the Minneapolis and Helena offices of the Federal Reserve Bank of Minneapolis on Oct. 15, 1966.

[37]Paper presented by Clement Van Nice and Dick Heiber before the joint meeting of the Board of Directors of the Minneapolis and Helena offices of the Federal Reserve Bank of Minneapolis on Oct. 15, 1966. (Copy in the possession of Dr. K. Ross Toole, Department of History, University of Montana.)

During the early phases of the 1920-1926 banking crisis the business cycle theory held by Federal Reserve officials supported a passive policy. As the period progressed, these ideas were slowly modified.[38] In 1921 the severe criticism of Federal Reserve policy resulted in a Congressional inquiry. Hearings were held on the role of the Federal Reserve System in the 1920 agricultural crisis. Rather than criticizing rediscount rate increases, the commission stated that action should have started earlier. In their opinion, Treasury Department policy should not have dictated Federal Reserve actions.[39] Once liquidation was under way the commission felt that Federal Reserve policy should have been softened slightly to ease the distress caused by the deflation.[40] These findings influenced the developing ideas about the proper role of the Federal Reserve System in the economy. Undoubtedly it provided officials with a strong motive to explore the proper role of the System further.[41]

It is doubtful whether lower rediscount rates would have provided a solution to Montana's difficulties. When banks are overextended as they were in 1921, an easy credit policy is not the answer to strengthening the position of the banking system. Further loans by the Federal Reserve would encourage banks to make further extensions of credit. It is clear that the Federal Reserve System did not

[38]Charles O. Hardy, Credit Policies of the Federal Reserve System (Washington, D. C., 1932), 43.

[39]U. S. Congress, Agricultural Inquiry, II, 12.

[40]U. S. Congress, Agricultural Inquiry, II, 88.

[41]Anderson, Federal Reserve Policymaking, 32.

function as a positive force to curb the deflation of the early 1920's to the fullest extent possible. However, it is equally clear that it was not used as a tool to force a rapid liquidation upon the banking system. In light of the economic theory of the time, Federal Reserve actions were reasonable. Certainly Federal Reserve policy cannot be assigned as a major factor in the widespread wave of banking failures.

CHAPTER IV

THE INFLUENCE OF AGRICULTURAL FACTORS

Banking operations were greatly affected by the agricultural conditions of the early 1920's. The wave of bank failures that occurred was in many respects a reflection of the widespread agricultural distress. Montana was affected by world-wide as well as peculiar local agricultural conditions during this period. As an area of surplus agricultural production, the general prosperity of the state was closely related to conditions in the agricultural markets. Banks located in agricultural regions were heavily dependent upon farm prosperity and generally lacked the financial strength of the larger city banks. As conditions in agriculture began to deteriorate following the First World War, the situation was quickly reflected in the banking system. Therefore, agricultural conditions during the early 1920's were an important part of the bank failure pattern and as such require further examination.

Between 1900 and 1920 the general position of agriculture in the economy continually improved in the United States. Demand for agricultural products increased more rapidly than production. Between 1899 and 1909, agricultural production increased 10 percent while population increased 21.5 percent. Between 1909 and 1919, agricultural production increased 10.5 percent while population increased 14.5 percent.[1] This large increase of demand for agricultural

[1] U. S. Congress, Agricultural Inquiry, I, 14.

products in relation to its production resulted in a period of agricultural prosperity.

The First World War created a period of great demand for agricultural products. United States exports of crude foodstuffs increased from $138 million in 1914 to a total in 1920 of $918 million.[2] However, agricultural production responded slowly to the increased war demand. It was not until after the armistice that production increased significantly. The agricultural production index (1935-1939=100) shows the slow change in output that took place: 98 in 1915; 92 in 1916; 90 in 1917; 95 in 1918; 96 in 1919; 101 in 1920.[3]

The result of the increased demand and slowly expanding agricultural supply was a sharp price increase. Wheat prices rose to over $2.50 per bushel. The index of farm prices (1909-1914=100) reached 200 in 1918 while the price index was 175 for necessary farm purchases.[4] Farmers enjoyed a relative increase in their purchasing power. As a result of this situation, the average net income of farmers between 1915 and 1919 rose from $4,395 to $9,877.[5] This farm prosperity was largely the result of high farm prices.

[2]George Soule, Economic Forces in American History (n.p., 1953), 374. Cited hereafter as Soule, Economic Forces.

[3]Ibid.

[4]August C. Bolino, The Development of the American Economy, (Columbus, Ohio, 1961), 339.

[5]Soule, Economic Forces, 375.

The nature of the increased agricultural production in the Northwest states[6] led to some post-war difficulties. Expansion in the production of food grains during the war left the area heavily dependent upon the market condition for these grains. In the years following the end of the war, export demand for wheat declined sharply. Although income in the United States was high during this period, demand for food grains did not increase in the same proportion. Increasing incomes were reflected in greater demand for such food products as fresh fruits and vegetables, fresh meats and poultry, and dairy products; the demand for food grains did not expand to the same extent. Declining grain exports were matched by the inability of the domestic market to absorb the increased production of food grains at prevailing prices.[7] The Northwest states, heavily dependent upon wheat production, were unable to take advantage of the post-war increases in income. It was during this critical period that wheat production in Montana, as illustrated by Table 19, increased rapidly.

TABLE 19

TOTAL WHEAT THRASHED IN MONTANA IN SELECTED YEARS, 1899-1924[a]

Date	Acres	Bushels
1899	92,132	1,899,683
1909	258,377	6,251,945
1919	1,698,531	7,799,647
1924	3,102,879	44,058,012

[a]Source: U. S. Bureau of the Census, Fifteenth Census of the United States: 1930. Agriculture, II, Pt. 3, 116.

[6]Includes Montana, North and South Dakota, and Minnesota.

[7]McCracken, Northwest in Two Wars, 11-12.

Between 1900 and 1920 the population of Montana increased rapidly. New lands were opened during this period of agricultural prosperity and settlers poured into the area. Table 20 shows that the number of farms in the state increased even more rapidly than the population. During the first two decades of the twentieth century, agriculture expanded rapidly in Montana.

The increased agricultural demand of the First World War led to a large increase in the amount of land devoted to agriculture in Montana. Between 1910 and 1920 the total area in farm land increased from 13.5 to 35.1 million acres. During the same period the value of farm land and buildings increased from $251.6 million to $776.8 million.[8]

TABLE 20

CHANGES IN POPULATION AND NUMBER OF FARMS IN MONTANA, 1880-1930[a]

Year	Population	Percent of Increase	No. of farms	Percent of Increase
1880	39,159	90.1	1,519	78.5
1890	142,924	265.0	5,603	268.9
1900	243,329	70.3	13,370	138.6
1910	376,053	54.5	26,214	96.1
1920	548,889	46.0	57,677	120.0
1930	536,332	-2.3	46,904	-18.7

[a]Source: Curtis L. Mosher, The Causes of Failure in the Northwestern States (Minneapolis, 1930), 28.

In the Northwest states the amount of cultivated land increased 16 2/3 percent while production increased only 5 percent during the war.

[8]U. S. Bureau of the Census, Fifteenth Census of the United States: 1930. Agriculture, II, Pt. 3, 116. Cited hereafter as Bureau of the Census, Fifteenth Census; 1930, Agriculture.

It is apparent from these figures that agricultural expansion had advanced into marginal and submarginal lands.[9] Much of this new farm land in Montana was suitable only for "dry land" farming--a type of farming that required a considerable amount of farming skill and experience. Farm failures were inevitable with the settlement of these areas by people with little farming background and experience. A 1923 study of areas of heavy farm failures in Montana revealed the results of this indiscriminate settlement. Of the farmers who failed, 51 percent had no previous farming experience and 30 percent had no capital.[10] This lack of farming experience was an important factor in the widespread farm failures in Montana.

Peculiar local conditions added to the difficulties of Montana farmers. Drought conditions began during the summer of 1917 and crops during that year were generally poor. Different areas were affected in different ways during the following years. However, drought conditions were generally a serious problem to farmers throughout the state. Rainfall in Shelby during 1916 was 15.26 inches. During the following years it declined rapidly: 9.96 inches in 1917; 8.88 inches in 1918; 6.86 inches in 1919. In 1919 Havre received only 8.85 inches of rain and only 7.74 inches fell in Glasgow.[11] The effect of the drought on wheat production was serious. From an average of 25 bushels an acre between 1910 and 1916,

[9]Mosher, Causes of Failure, 6.

[10]Ibid., 5.

[11]Toole, Uncommon Land, 235.

production averages in 1919 fell to 2 4/10 bushels per acre. At prevailing prices this meant a $50 million loss to Montana.[12] Table 21 illustrates the decline that took place in agricultural productivity.

TABLE 21

AVERAGE NUMBER OF BUSHEL YIELD PER ACRE IN MONTANA FOR SELECTED CROPS, 1909 AND 1919[a]

Product	1909	1919
Wheat	24.2	4.6
Hay and Forage (tons)	1.49	0.83
Corn	28.8	8.5
Oats	41.4	13.5
Barley	27.6	11.8
Rye	18.4	3.0
Flax Seed	11.9	2.5

[a]Source: U. S. Bureau of the Census, Fourteenth Census of the United States: 1920. Agriculture, II, Pt. 3, 104.

Conditions continued to place the farmer in a serious position. Many farmers were unable to meet their payments on their bank loans and many loans were renewed. In 1918 farmers borrowed heavily to plant crops; the drought continued and crops were poor. Drought conditions continued into 1919 and many streams dried up to their headsprings.[13] Throughout these years harvests were small and feed was scarce. To compound the difficulties, winter began early in 1919 and lasted until May of the following year. Feed for livestock had to be shipped in and by spring ranchers had expended $45 million to save

[12]Toole, Uncommon Land, 235-36.

[13]Annual Report of the Banking Department, 1924, 11.

their herds. As summer approached, livestock that had survived the severe winter were faced with bare ranges. At the same time the price of beef began to decline sharply and stockmen found that their livestock was worth less than their maintenance cost through the winter. Many prosperous stockmen were ruined.[14]

Poor agricultural conditions continued. In 1920 Montana experienced its fourth successive crop failure. Declining prices and poor crops led to a strain on banks that had already stretched their credit capacity to carry farmers through the past four years.[15] This owerextension of credit by Montana banks led to serious difficulties. For five years Montana crops failed to yield any return above the cost of production. Banks continued to grant renewals and extensions since foreclosure was the only other alternative. Since land values had declined sharply, such a course of action generally was not a practical solution. Banks were soon in a difficult position as loans increased and deposits decreased. Banks borrowed to meet deposit withdrawals and pledged assets as security for the loans. As the downward spiral continued, bank assets continued to depreciate in value. The situation resulted in a widespread wave of bank failures as banks began to "fall by sheer exhaustion."[16]

The sharp price declines of 1920 added difficulties to the already serious agricultural situation. When world purchasing power

[14] Annual Report of the Banking Department, 1924, 11. See also Mosher, Causes of Failure, 10-11.

[15] Annual Report of the Banking Department, 1920, 4.

[16] Annual Report of the Banking Department, 1922, 13.

began to decline following the First World War, the export demand for American agricultural products began to fade. As agricultural prices declined, the purchasing power of the agricultural community--nearly 40 percent of the total--began to decline. The impact of this decline resulted in a decrease of demand for industrial products and an increase in unemployment.[17] Between 1919 and 1921 a decline from 215 to 124 took place in the price index for farm products. At the same time the price index fell from 202 to 152 for items that farmers purchased. As a result of these changes, farmers in 1921 could purchase only three-quarters as much with their current income as they could before the war. Between 1919 and 1921 the gross farm income in the United States declined from $17,710 million to $10,478 million. The relationship of farm income to farm expenses did not recover its 1910-1914 level until the Second World War.[18]

The price declines that vitally affected Montana in 1920 were closely related to world-wide conditions. The sharp declines were not caused by overproduction or overmarketing in the United States. However, the decline of export demand for agricultural products was an important factor. Since agricultural products generally are produced in surplus quantities in the United States, a small change in export demand exerts a great influence on domestic prices. Unless excess production is absorbed by exports it tends to depress agricultural prices.[19] The price decline of 1920 was largely the result of this situation.

[17]U. S. Congress, Agricultural Inquiry, I, 17.

[18]Soule, Economic Forces, 377.

[19]U. S. Congress, Agricultural Inquiry, I, 15.

The extent of the price decline of 1920 was a major factor in determining the farm prosperity of the early 1920's. In 1921 the index of selected farm product prices (1909-1914=100) revealed the sharp declines that had taken place: wheat, 78; beef cattle, 71; sheep, 64; wool, 63; average of 31 selected agricultural products, 67.[20] By 1921 the purchasing power of the farmer's dollar was 76 cents in terms of 1913 dollars.[21] This was the lowest point it had reached in thirty years.[22]

The value of agricultural land is a useful index to measure farm prosperity. The value of farm land generally increased while farm prices were high and future prospects were bright. As farmers prospered, savings were reinvested in additional land--the traditional pattern followed by American farmers. Between 1910 and 1920 the average value of farm land in the United States rose from $19.81 to $69.38 per acre.[23] In the four Northwest states, farm land values increased between 1915 and 1920 by 75 percent.[24] Bankers shared the optimism of the period and the rise in farm land value reflected the overextension of bank credit.

Farm mortgage debt expanded rapidly. This large increase was the product of the First World War land boom. Mortgage amounts increased more rapidly than either the value of farm land and

[20] U. S. Congress, Agricultural Inquiry, I, 31.

[21] Ibid., 28.

[22] Ibid., 13.

[23] Soule, Economic Forces, 375.

[24] McCracken, Northwest in Two Wars, 3.

buildings or farm production. The increase of farm mortgage debt illustrated by Table 22 is striking. In Montana the percentage of owned farms mortgaged increased rapidly: 15.6 percent in 1890; 14.0 percent in 1900; 21.1 percent in 1910; 64.6 percent in 1920.[25] The average rate of interest paid on these farm mortgages was 7.6 percent.[26] This increased cost of farm operation created an additional financial burden in the following years. Payment of interest on this inflated debt structure required a disproportionate part of current farm income. This decline in farm purchasing power for goods and services further depressed business activity.

TABLE 22

TOTAL FARM MORTGAGE DEBT OF OWNERS OPERATING THEIR OWN FARMS, 1910-1920[a]

Area	1910	1920
Minnesota	$77,866,283	$254,475,222
North Dakota	48,841,587	108,284,682
South Dakota	32,771,359	90,082,346
MONTANA	10,741,280	77,949,679
Total--Northwest States	$169,220,509	$530,791,929
Total--United States	$1,726,200,000	$4,012,700,000

[a]Source: Curtis L. Mosher, The Causes of Banking Failure in the Northwestern States (Minneapolis, 1930), 28.

Commercial banks assumed an active role in the expansion of the farm mortgage debt. Banks became a center for farm land transactions and bankers became involved in profitable land speculations.

[25]U. S. Congress, Agricultural Inquiry, I, 206.

[26]Ibid., 208.

As an active participant in speculative land transactions, the banker was not in a position to urge a conservative view of farm land values.[27] Farmers with first mortgages found it relatively easy to obtain funds to expand operations by giving a second mortgage. Bank officers often encouraged land purchases through low down-payment requirements and easy repayment terms. Unsecured notes often were accepted for the balance due on land purchases. The subsequent criticism by bank examiners generally forced the conversion of these notes into second mortgages. With the collapse of farm land values in 1920, banks found themselves holding large amounts of worthless second mortgages representing an equity in unsalable land.[28] Banks often held portfolios that were overburdened with slow and frozen earning assets.

The debt burden created during the years preceding 1920 had a disastrous effect on farmers after the sharp price declines. Falling agricultural prices made it difficult for farmers to meet payments on mortgage debts and to purchase necessary supplies. Farm debt had more than doubled during the 1910-1920 period; the price declines of 1920 had the effect of again doubling this farm debt.[29] As a result, farm foreclosures as a percentage of the total number of farms increased rapidly in the United States: .4 percent during the war; 1.2 percent in 1922; 1.5 percent in 1923; 1.7 percent in 1924. The proportion of farm bankruptcies to the total bankruptcies in the country rose from 7 to 18 percent.[30]

[27]Mosher, Causes of Failure, 16.

[28]Ibid., 16-17.

[29]U. S. Congress, Agricultural Inquiry, I, 20.

[30]Soule, Economic Forces, 377.

In Montana the tragedy was even more striking than the nation-wide experience. The average value of farm land and buildings declined between 1920 and 1925 from $22.15 to $13.91 per acre.[31] The total value of farm land and buildings declined from $776,767,529 to $455,394,887 in the state.[32] During a period of highly inflated farm debt based on high land values, such a decline inevitably affected the banking operations of the area.

The combination of these agricultural factors was an important part of the bank failure story in Montana during the early 1920's. Indeed, the Superintendent of Banking in Montana attributed Montana's financial crisis to three causes: "Deflation, Drouth and the High Tastes of its people."[33] The first two factors refer to the agricultural situation during this period. Rapidly falling farm prices and farm income were faced by a highly inflated farm debt situation. Local drought conditions and an economy that produced agricultural goods that were insensitive to rising national income left Montana in a difficult position. Banks of the area were generally small banks that lacked financial diversification. Generally, they were small rural institutions that were closely tied to the local farm economy. With the drastic agricultural crisis of the early 1920's, many banks were unable to withstand the resulting financial pressures. The widespread wave of bank failures in Montana during the 1920's was in part a reflection of this agricultural distress.

[31]U. S. Bureau of the Census, Census of Agriculture: 1954. Montana: Counties and State Economic Areas (Washington, D. C., 1956), 2.

[32]U. S. Bureau of the Census, Fifteenth Census: 1930, Agriculture, 116.

[33]Annual Report of the Banking Department, 1922, 13.

CHAPTER V

FINANCIAL STRENGTH AS A FACTOR IN BANK FAILURES

Changes of financial account balances during the 1920-1926 period were an important part of the bank failure pattern in Montana. An examination of these account balances reveals many of the financial weaknesses that were an important factor in bank failures. Changes in balance sheet account balances may reveal the success of bank management in meeting the unforeseen difficulties of this period. Such changes in accounts provide a useful picture of banking operations in Montana as banks struggled for survival during the early 1920's.

The division of Montana banks into failing and non-failing categories used in Chapter II can be utilized to examine some of the differences that existed in the account balances of these two groups. For this purpose a comparative balance sheet has been constructed in Table 23 that includes both failing and non-failing banks. Further detail is provided in Table 24 and Table 25 for national and state banks in Montana. A comparison of the percentage columns of these statements reveals the differences that existed in 1920 between these two groups of banks.

TABLE 23

COMPARATIVE BALANCE SHEET FOR FAILING AND NON-FAILING COMMERCIAL BANKS IN MONTANA IN 1920[a]

	Failing		Non-Failing	
ASSETS	Amount (millions)	Percent of Total	Amount (millions)	Percent of Total
Loans, Discounts, Overdrafts	$65.1	75.4	$79.8	64.7
Bonds, Investments, Real Estate	9.6	11.1	18.8	15.2
Legal Reserve	3.9	4.5	8.7	7.0
Other Assets	7.7	9.0	16.0	13.1
Total	$86.3	100.0	$123.3	100.0
LIABILITIES				
Demand Deposits	$29.5	34.1	$49.3	40.0
Time Deposits	25.5	29.5	39.8	32.2
Other Liabilities	19.3	22.4	16.9	13.7
Total	$74.3	86.0	$106.0	85.9
CAPITAL ACCOUNTS				
Capital	$8.5	9.9	$10.1	8.2
Surplus and Undivided Profit	3.5	4.1	7.2	5.9
Total	$12.0	14.0	$17.3	14.1
Total	$86.3	100.0	$123.3	100.0

[a]Calculated from individual balance sheet statement of national banks on Sept. 8, 1920, included in the Annual Report of the Comptroller of the Currency. State bank statements are taken on Nov. 15, 1920, from the Annual Report of the Banking Department in Montana. Only banks in business on these dates are included.

TABLE 24

COMPARATIVE BALANCE SHEET FOR FAILING AND NON-FAILING COMMERCIAL STATE BANKS IN MONTANA[a]
November 15, 1920

	Failing		Non-Failing	
ASSETS	Amount (thousands)	Percent of Total	Amount (thousands)	Percent of Total
Loans, Discounts Overdrafts	$257.3	80.5	$340.7	68.8
Bonds and Warrants	16.4	5.1	53.4	10.8
Legal Reserve	17.6	5.5	53.5	10.8
Due from Other Banks	2.8	.9	9.6	1.9
Other Real Estate	3.7	1.2	4.0	.8
Other Assets	21.6	6.8	34.6	6.9
Total	$319.4	100.0	$495.8	100.0
LIABILITIES				
Bills Payable	$58.9	18.4	$38.9	7.9
Due to Banks	5.4	1.7	13.8	2.8
Demand Deposits	108.8	34.1	197.6	39.9
Time Deposits	96.1	30.1	171.5	34.6
Other Liabilities	1.8	.5	.4	.1
Total	$271.0	84.8	$422.2	85.3
CAPITAL ACCOUNTS				
Capital	$35.9	11.2	$47.5	9.6
Surplus	8.9	2.8	16.7	3.3
Undivided Profits	3.6	1.2	9.4	1.8
Total	$48.4	15.2	$73.6	14.7
Total	$319.4	100.0	$495.8	100.0

[a]Calculated from individual balance sheet statement of state banks on Nov. 15, 1920, taken from the Annual Report of the Banking Department in Montana. Only banks in business on that date are included.

TABLE 25

COMPARATIVE BALANCE SHEET FOR FAILING AND NON-FAILING COMMERCIAL NATIONAL BANKS IN MONTANA[a]
September 8, 1920

	Failing		Non-Failing	
ASSETS	Amount (thousands)	Percent of Total	Amount (thousands)	Percent of Total
Loans, Discounts, Overdrafts	$392.8	69.9	$602.2	61.4
U. S. Government Securities	42.4	7.5	83.5	8.5
Other Investments and Real Estate	50.4	9.0	96.0	9.8
Legal Reserve with Federal Reserve	18.6	3.3	38.6	3.8
Other Assets	58.3	10.3	162.5	16.5
Total	$562.5	100.0	$982.8	100.0
LIABILITIES				
Demand Deposits	$193.5	34.4	$394.7	40.2
Time Deposits	162.4	28.9	296.8	30.2
Other Liabilities	134.9	24.0	161.3	16.4
Total	$490.8	87.3	$852.8	86.8
CAPITAL ACCOUNTS				
Capital	$47.8	8.5	68.7	7.0
Surplus and Undivided Profits	23.9	4.2	61.3	6.2
Total	$71.7	12.7	$130.0	13.2
Total	$562.5	100.0	$982.8	100.0

[a]Calculated from individual balance sheet statements of national banks on Sept. 8, 1920, included in the Annual Report of the Comptroller of the Currency. Only banks in business on this date are included.

Generally, differences in account balances between the two groups of banks were small. Failing banks held a larger percentage of their assets in the form of loans and discounts than non-failing banks. Investments accounted for a smaller percentage of the total assets of failing banks. Failing banks held a smaller percentage of their liabilities as demand and time deposits than non-failing banks. The capital accounts were about the same for both groups. These differences, although not striking or large, indicate a tendency for failing banks to be more heavily extended in loans than non-failing banks; the source of these funds were less deposits than other liabilities.

Important account balance changes took place throughout the early 1920's. An examination of these changes in account balances and of financial ratios during this period provides some insight into the financial strength of the banking system. A comparison of Montana banks with the averages for the United States as a whole, provides a basis for evaluation of financial position.[1] It should be noted that as banks failed, they were eliminated from the statistics of active banks upon which these comparisons are based. Therefore, as the period progressed, the amounts increasingly tended to represent the stronger banks that had survived the crisis. Recognizing this fact, the account balances and ratios are still valuable in determining the changes that occurred in the banking system during this period.

[1]A desirable comparison would be of failing and non-failing banks in Montana throughout the early 1920's. However, statements for state banks are published by the state Banking Department and for national banks by the Comptroller of the Currency. Since statement dates vary widely for these two groups, it was impractical to construct a comparison on this basis.

The amount of total resources of a commercial bank is an important consideration in determining its financial strength. Normally, the amount of total resources of a healthy growing bank will increase. During periods of increasing total resources, the greatest gains generally are made by non-failing banks. Decreasing total resources are more common for failing banks as a group than for non-failing commercial banks.[2] An examination of Table 26 shows that the total resources of Montana banks increased more slowly during periods of increase and fell more rapidly during periods of decline than the nation-wide bank averages. Generally, this indicates that Montana banks were in a less favorable financial condition. However, this factor cannot be considered in isolation of other account balances; it is only one consideration.

TABLE 26

CHANGES IN THE TOTAL RESOURCES OF STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

Year	Montana		United States	
	Amount (millions)	Percent of Change	Amount (millions)	Percent of Change
1918	$202.3		$36,352	
1919	223.7	+11	42,462	+16
1920	234.9	+ 5	47,509	+12
1921	210.1	-11	43,669	- 8
1922	197.6	- 6	44,106	+ 1
1923	187.6	- 5	47,332	+ 7
1924	147.2	-22	50,137	+ 6
1925	160.6	+ 9	54,402	+ 9
1926	165.2	+ 3	56,781	+ 4
1927	170.4	+ 3	58,973	+ 4

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

[2]Horace Secrist, National Bank Failures and Non-Failures; An Autopsy and Diagnosis (Bloomington, Indiana, 1938), 11. Cited hereafter as Secrist, National Bank Failures.

The operations of a commercial bank are sustained by the earnings of its assets. The most important of these are the loans and discounts and the investments held by the bank for income purposes. Therefore, changes in these account balances are of primary importance to any assessment of financial strength. Generally, a significant decline in the earning assets of a bank is a sign of financial weakness. Failing banks tend to experience larger declines in their earning assets than non-failing banks.[3] An examination of Table 27 shows that the earning assets of Montana banks increased slower during periods of growth and declined faster during periods of decrease than the nation-wide averages. Generally, these figures indicate that Montana banks were in a less favorable financial position than those of the nation as a whole.

TABLE 27

CHANGES IN TOTAL EARNING ASSETS OF STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

Year	Montana		United States	
	Amount (millions)	Percent of Change	Amount (millions)	Percent of Change
1918	$153.8		$28,050	
1919	167.8	+ 9	32,335	+15
1920	189.5	+13	36,960	+14
1921	170.6	-10	34,746	- 6
1922	155.8	- 9	34,400	- 1
1923	146.6	- 6	37,722	+10
1924	105.6	-28	38,957	+ 3
1925	118.2	+12	41,978	+ 8
1926	123.9	+ 5	44,308	+ 6
1927	130.2	+ 5	46,097	+ 4

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

[3]Secrist, National Bank Failures, 13.

Deposits left with a bank are a major source of funds for bank investment. Since these funds are invested largely in customer loans and other earning assets, a continued or sudden decline of this account places the bank in a difficult financial position. Most bank assets cannot be converted into cash immediately. Therefore, sudden declines place the bank in an embarrassing position since quick liquidation of assets often involves a loss to the bank. A more gradual but continual decline in deposits results in a decrease of earning assets and "starvation" of the bank. It is apparent, therefore, that failing banks tend more often to have declining deposit totals than non-failing banks.[4] Table 28 indicates the changes that occurred in total deposits during the early 1920's. Generally, total deposits of Montana banks increased at a slower rate and decreased more rapidly than the nation-wide averages. These changes indicate that Montana banks were in a less favorable financial position.

Changes in the capital accounts do not always reflect a change in the banks' financial strength. The amount of capital funds needed by a bank depends upon such factors as the volume of bank business, size of deposits and other liabilities, the liquidity of the banks earning assets, and other factors. However, the surplus account is of some importance as a reflection of bank earnings. Profits not distributed to owners are eventually added to this account; operating losses are eventually charged to the surplus account. In this sense, the changes that take place in the capital accounts are of some importance. The adequacy of capital account balances can only be

[4]Secrist, National Bank Failures, 12.

judged in relationship to other accounts. Generally failing banks experienced larger decreases in their capital account balances than non-failing banks.[5] Table 29 indicates the changes that took place in capital account balances during this period.

TABLE 28

CHANGES IN THE TOTAL DEPOSITS OF STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

	Montana		United States	
Year	Amount (millions)	Percent of Change	Amount (millions)	Percent of Change
1918	$157.4		$28,708	
1919	181.3	+15	33,254	+16
1920	172.2	- 5	36,682	+10
1921	146.2	-15	33,431	- 9
1922	138.2	- 6	35,533	+ 6
1923	141.3	+ 2	38,175	+ 7
1924	119.4	-16	41,443	+ 9
1925	136.7	+15	45,230	+ 9
1926	142.1	+ 4	46,951	+ 4
1927	148.0	+ 4	48,704	+ 4

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

A ratio used to determine the adequacy of capital funds is the total capital funds to total deposits ratio. Conventional thought during the 1920's maintained that a 10 percent minimum was necessary for operating safety. The conclusions of a study of failing national banks during this period indicates that this general rule was false. Generally, ratios were lower for non-failing banks in the study than for failing banks. The 10 percent rule is illusory; 54 percent of the failing banks included in the study had ratios in excess of

[5]Secrist, National Bank Failures, 14.

20 percent.[6] This relationship is demonstrated in Table 30 by the comparison of Montana and nation-wide bank averages. Montana banks failed at a higher rate than the average for the United States, yet the Montana ratios of total capital accounts to deposits were higher than the nation-wide averages. The conclusion drawn from this relationship is that the margin provided by owners in the form of capital is never sufficient to cover the liabilities of the bank. Its purpose is to establish customer confidence and if this confidence is disturbed, the amount of capital is not sufficient to offset rapid deposit withdrawals. In this case it would take more than a high ratio of total capital funds to total deposits to restore the bank's financial position.

TABLE 29

CHANGES IN THE CAPITAL ACCOUNT BALANCES OF STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

Year	Montana		United States	
	Amount (millions)	Percent of Change	Amount (millions)	Percent of Change
1918	$28.7		$4,743	
1919	30.5	+ 6	5,014	+ 6
1920	32.5	+ 6	5,599	+12
1921	31.4	- 3	5,936	+ 6
1922	29.7	- 5	6,043	+ 2
1923	27.4	- 8	6,220	+ 3
1924	19.5	-29	6,421	+ 3
1925	18.8	- 4	6,637	+ 3
1926	18.4	- 2	7,022	+ 6
1927	18.2	- 1	7,392	+ 5

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

[6]Secrist, National Bank Failures, 18-19.

TABLE 30

CHANGES IN THE RATIO OF TOTAL CAPITAL FUNDS TO TOTAL DEPOSITS FOR STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

Year	Montana	United States
1918	.182	.165
1919	.168	.150
1920	.188	.152
1921	.214	.177
1922	.215	.170
1923	.194	.162
1924	.163	.154
1925	.137	.146
1926	.129	.149
1927	.123	.151

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

The same relationship exists between total capital funds and total liabilities that prevailed in the comparison with total deposits.[7] Table 31 illustrates the relationship of these accounts as they existed during the early 1920's.

TABLE 31

CHANGES IN THE RATIO OF TOTAL CAPITAL FUNDS TO TOTAL LIABILITIES FOR STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

Year	Montana	United States
1918	.165	.150
1919	.157	.133
1920	.160	.133
1921	.175	.157
1922	.176	.158
1923	.171	.151
1924	.153	.146
1925	.132	.138
1926	.125	.141
1927	.119	.143

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

[7]Secrist, National Bank Failures, 18-19.

A comparison of total loans and discounts to total deposits indicates the extent that funds are invested in the form of loans. The total amount of loans is often difficult to decrease significantly in a short period of time without injuring the customers of the bank and therefore the local economy. Loans are a relatively illiquid form of bank investment. It is because of this characteristic that banks, heavily overextended in loans, experienced financial difficulties during the periods of rapid deposit withdrawals. Generally, failing banks have a higher ratio of total loans and discounts to total deposits than non-failing banks.[8] Table 32 shows that this relationship was true in the comparison of Montana banks with the nation-wide averages. Indeed, in 1921 the ratio approached 100 percent in Montana as loans failed to decline as rapidly as deposits. This situation began to change during the later years of the period as bank failures declined in Montana.

The ratio of total deposits to total resources provides another important indication of banking strength. Successful banking operations depend to a great extent on a bank's ability to attract deposits and to profitably invest these funds. The higher the proportion of deposits to total resources, the higher the leverage factor and therefore the profitability to the bank owners. Generally, failing banks have a relatively low ratio of total deposits to total resources.[9] This situation, as illustrated by Table 33, was true in Montana during the severe wave of bank failures during the early 1920's.

[8]Secrist, National Bank Failures, 15-16.

[9]Ibid., 17.

TABLE 32

CHANGES IN THE RATIO OF TOTAL LOANS AND DISCOUNTS TO TOTAL DEPOSITS FOR STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

Year	Montana	United States
1918	.827	.716
1919	.753	.686
1920	.943	.778
1921	.985	.789
1922	.964	.704
1923	.847	.717
1924	.657	.682
1925	.576	.668
1926	.567	.683
1927	.566	.676

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

These relationships indicate that Montana commercial banks generally were financially weaker than the nation-wide bank averages. This is, to some degree, an indication of management's failure to meet the financial crisis that faced them. The account balances indicate the financial weaknesses that made it difficult for Montana banks to withstand the severe crisis that faced them.

One of the most severe problems that faced Montana bankers during this period was the sharp decline of deposits and their inability to contract their assets in proportion to these increasing cash demands. This factor is pointed to by Federal Reserve officials as an important cause of nation-wide bank failures during this period.[10] In Montana this situation was complicated by an inflow of deposit funds from other states during the years preceding the 1920 crisis. Farm

[10]Annual Report of the Federal Reserve Board, 1926, 13.

mortgages carried high interest rates and enabled Montana banks to pay relatively high interest rates on deposits. With the sharp declines in farm land values in 1920, Easterners became alarmed and began to withdraw their funds from Montana banks. The difficulty that this action created was the conversion of earning assets quickly into cash.[11] In addition to this difficulty, many banks had sold farm mortgages to investors with a guarantee provision for the payment of the principal and interest on the mortgage. As payments were suspended during the crisis, mortgage holders began to demand that banks fulfill their guarantee obligations.[12] Table 34 shows the volume of funds between 1920 and 1921 that left Northwest banks.

TABLE 33

CHANGES IN THE RATIO OF TOTAL DEPOSITS TO TOTAL RESOURCES FOR STATE AND NATIONAL COMMERCIAL BANKS IN MONTANA AND THE UNITED STATES, 1918-1927[a]

Year	Montana	United States
1918	.777	.789
1919	.810	.783
1920	.732	.772
1921	.696	.765
1922	.699	.805
1923	.753	.806
1924	.811	.826
1925	.851	.831
1926	.860	.826
1927	.868	.825

[a]Source: Calculated from statistics in All-Bank Statistics: United States, 1896-1955, Board of Governors of the Federal Reserve System (Washington, D. C., 1959), 38-45, 606-613 passim.

[11]Paul W. McCracken, The Future of Northwest Bank Deposits, Federal Reserve Bank of Minneapolis (Minneapolis, 1946), 3.

[12]Mosher, Causes of Failure, 8-11.

TABLE 34

FUNDS LEAVING NORTHWEST STATES, 1920-1921[a]

State	Amount (millions)	Percent of Total Assets 6/30/20
MONTANA	$ 32	14
Minnesota	150	12
North Dakota	57	22
South Dakota	66	20
Total	$305	15

[a]Source: Paul W. McCracken, The Northwest in Two Wars, Federal Reserve Bank of Minneapolis (Minneapolis, n. d.), 7.

As deposits declined, loss of confidence by bank depositors became a factor. The failure of a bank often frightened depositors of other banks into withdrawing their funds. This loss of confidence was indicated by a decline of $30 million in the deposits of Montana banks during a period when a net decrease of only two banks took place. The Assistant Federal Reserve Agent of the Minneapolis Bank insisted that enough money had been withdrawn and "hidden out" to restore the declining deposits of all of Montana's agricultural banks.[13]

The situation became a vicious circle. As business activity declined, bank deposits were withdrawn to pay bills and purchase necessary items. With the decline of deposits, banks were forced to contract loans which further depressed business activity. In addition to liquidating their loans, banks were forced to borrow from correspondent banks and the Federal Reserve bank to meet the financial demands. The entire situation was one of overextended banks generally unable to meet the financial crisis. The financial weakness of

[13]Groth, "Montana Banking History," 45.

Montana banks during this period was certainly an important factor in the failure of the banking system to meet the conditions that faced it. The widespread wave of bank failures reflected this financial condition.

CHAPTER VI

SIZE AS A FACTOR IN BANK FAILURES

The size of the commercial bank was an important factor in its ability to withstand the financial pressures of the 1920-1926 period. Although increased size did not always indicate increased financial strength, the larger banks generally enjoyed a greater degree of financial stability. Generally, small banks failed more often than the larger banks. This relationship was true whether the size of the bank was measured by capitalization, amount of total resources, or the amount of the bank's total deposits.[1] This relationship was true on both the nation-wide level and in Montana. Of the nation-wide bank failures in 1924 and 1925, 40 percent of the banks had capital of less than $25,000 and 70 percent had less than $50,000 in capital.[2] In 1926 the average capital account balance of all failing banks in the United States was $35,000 and $288,000 in total deposits. At the same time the nation-wide averages for all banks were $116,000 in capital and $1,900,000 in deposits.[3] For the nation as a whole, failing banks during the early 1920's were generally small institutions.

In Montana, the same relationship between size and failure rate was true. Banks with capitalization of less than $30,000 accounted for 73.9 percent of the failing banks and 58.8 percent of the non-failing banks examined. Banks with total resources of less than

[1] Supra, Tables 6, 7, 8.

[2] Annual Report of the Federal Reserve Board, 1925, 32.

[3] Annual Report of the Federal Reserve Board, 1926, 12.

$500,000 accounted for 83.2 percent of the failing and 68.7 percent of the non-failing group. Banks with total deposits of less than $350,000 included 84.1 percent of the failing and 70.9 percent of the non-failing banks. These percentages reveal the small size of failing banks during this period in Montana.

The relationship of bank size to bank failure rate was recognized clearly by contemporary authorities on banking. The role of government supervision in the problem of bank failures during this period was discussed in considerable detail. The nation-wide epidemic of bank failures was confined largely to small banks in small towns. Generally, these areas were agricultural. Government policy in the chartering of banks was responsible, in part, for the creation of the large number of small banks.[4] The divided nature of governmental bank supervision led to governmental competition in the granting of bank charters and the subsequent regulation of banking operations. The result of this situation was a highly competitive banking system largely composed of numerous small unit banks. These banks fiercely competed for the available business and found it difficult, as a result of this competition, to pursue conservative banking practices. During the years following the First World War, banks generally prospered in spite of management policies. The inexperienced bank management that existed was in part the product of this small unit banking system. Individuals who knew little about financial

[4] See Chapter III for a discussion of the role of governmental charter policy and its relationship to bank failures during this period.

operations or general economic trends were permitted to establish banks because of their personal integrity and possession of the necessary amount for minimum capital requirements.[5] Such a basis was not sufficient to provide sound bank management. The amount of business available to the small rural bank precluded the employment of experienced bank managers. One author points to this difficulty by stating that "no community can possibly provide adequate resources, competent officers, and experienced directors for one bank to every 750 of its inhabitants as in North Dakota, or to 1,400 as in Iowa."[6] In Montana the ratio in 1921 was 1,370 inhabitants to each bank.[7]

Other more general economic forces were at work to decrease the importance of the small rural bank. Advances in transportation and communication facilities increasingly extended the urban influence into rural areas. This invasion meant a decline of rural bank business. Large city-centers were often within reach of rural areas. For various reasons, residents in rural areas often found it advantageous to utilize the facilities of large city banks rather than small local institutions. In addition, other business enterprises invaded rural areas and branches of city firms became common in the small communities. Receipts from these branches were sent to home offices where they were deposited in large city banks. These factors alone were enough to make serious inroads into rural banking business. In addition to these factors, city banks enjoyed a larger

[5]Anderson, Control of Banking, 315.

[6]Willit, Banking, 126.

[7]Supra, Table 1.

degree of financial flexibility and often could meet credit demands that local banks, because of their limited resources, were unable to satisfy. These factors combined to decrease the importance of the small rural bank.

The geographical distribution of bank failures in Montana emphasized their rural agricultural nature. The area in Montana east of the Continental Divide experienced the failure of 56.4 percent of its banks during the 1920-1926 period; in the area west of the Divide, 38.5 percent of the banks failed. Although the entire state economy was largely agricultural, the eastern portion was more heavily dependent upon agricultural production. In addition to this factor, the size of community where bank failures occurred supports the contention that the wave of bank failures was primarily a small-bank--small town phenomena. In the United States, 37 percent of the bank failures were located in towns of less than 500 inhabitants, 78 percent in towns of less than 2,500, and 96 percent in cities of less than 25,000 population.[8] In Montana, 57.9 percent of the failing banks were located in communities of less than 500 population.[9]

In addition to being relatively small rural banks serving sparcely populated agricultural areas, failing banks in Montana were relatively new institutions. Many of the banks that failed had existed only a short time prior to the banking crisis of the early 1920's. Only 3 percent of the failing banks and 9 percent of the non-failing banks were in business prior to 1900 in Montana. Of these failing

[8] Annual Report of the Federal Reserve Board, 1925, 32.

[9] Supra, Table 10.

banks, 79 percent were incorporated during the 1910-1920 period; 68 percent of the non-failing bank group were incorporated during the same period.[10] Lacking operating experience during periods of economic stress, Montana banks faced grave difficulties during the severe conditions of the early 1920's.

The critical problem that faced the small bank was essentially its inability to achieve financial diversification of its earning assets. Generally, the small size of rural banks confined its operations to a small locality and a limited number of enterprises and industries. Therefore, small banks lacked the ability and resources to adequately diversify their financial holdings and thereby to protect against economic fluctuations. This spreading of risk was an accepted method of protecting against declines in different economic sectors and industries. Since the small rural banks in Montana were closely related to their local economy, their investments and loans were heavily dependent on local conditions. Little financial diversification was possible. This investment policy was profitable while the value of rural agricultural land was increasing and farm mortgages were yielding high returns. With the price declines of 1920 and the serious conditions caused by the drought, the basis of bank prosperity was undermined. The lack of financial diversification was fatal. Indeed, Mr. J. W. Pole, the Comptroller of the Currency, pointed to the lack of diversification as the primary and fundamental cause of the difficulties of country banks during this period.[11]

[10] Supra, Table 11.

[11] Bradford, Banking, 431-32.

With the widespread wave of bank failures in the 1920's, proposals were advanced to correct the inherent weaknesses of the banking system. The basic weakness of the small unit banking system as it developed in the United States was well recognized prior to the 1920 crisis. With the widespread bank failures of this period, the need for corrective action became even more apparent. Unit banking proponents staunchly defended the system as the best system to fulfill the local credit needs of an area. The unit banker was a local man who knew the individual character of inhabitants and the local credit needs of his community. There was a strong resistance on this basis to outside interference in local affairs.

The proponents of branch and group banking pointed to its advantages as an answer to the small rural bank problems. Branch or group banking allowed the diversification of loans and investments with a resulting decrease in the credit risk. In addition, since loan demand varied, the branch banking system could easily transfer funds from area to area resulting in better utilization of available capital. This process would result in more uniform interest rates between different areas. In addition, the extension of credit by a branch system could be undertaken safely with a smaller reserve than would be necessary for a unit system. The entire system would provide for a more efficient utilization of available capital as well as allowing the employment of more highly trained personnel.[12] It was pointed out that the operation of small unit banks resulted in high operating costs because of the high overhead expenses in relation to the small volume of

[12]Bradford, Banking, 413.

business. This problem would be solved by a branch banking system.[13] Against these advantages, unit bank proponents argued that branch bankers lacked the intimate knowledge of local affairs and individuals that was essential to proper credit distribution. It was assumed that local banks were able to judge better the credit needs of the local community.

The encouragement of group and branch banking in many respects seemed to be the answer to the small bank dilemma. Branch or group banks could provide the services needed by rural areas without loss of diversification of assets and financial strength. The proposal was an attempt to overcome the disadvantages presented by the small size of rural banks. In many respects it provided a reasonable solution to a serious rural banking problem: the small size of banking institutions. As such it represented a notable step toward providing rural areas with the banking stability available to city residents in the same general area.

[13] Anderson, Control of Banking, 315.

CHAPTER VII

CONCLUSIONS

Failing banks in Montana during the 1920-1926 period had several distinct characteristics. Generally, state banks failed more often than national banks and the same relationship existed between state non-member and Federal Reserve member banks. Failing banks were usually small institutions whether measured by capital, total deposits, or total resources. Failures occurred more often in the area east of the Continental Divide than in the western portion of the state. Generally, failing banks were located in small communities. In addition, failing banks were relatively new institutions with nearly one-half of the total number having a life-span of five years or less.

The role of governmental actions in the bank failures of this period is of considerable importance. Governmental authorities contributed to a weakening of the banking system through the granting of an excessive number of bank charters and the competitive lowering of banking requirements. Indeed, the overbanked condition of Montana was an important factor in the bank failures of this period. Competition between governmental authorities made officials reluctant to strictly enforce or strengthen banking requirements. In this sense, the actions of the Banking Department in Montana and the Comptroller of the Currency were partially responsible for the bank failures in Montana during the early 1920's.

The role of the Federal Reserve System in the bank failures of this period received a considerable amount of attention. Rediscount rate policy was sharply criticized as a conscious effort by the Federal Reserve System to force a rapid liquidation of banking credit.[1] This accusation was not true. In 1920 the Federal Reserve System initiated a policy of restricting credit in an effort to relieve inflationary pressures. This policy was long overdue. Since open-market operations were not generally used as a tool for credit control until a later date, this policy relied upon an increase in the rediscount rate. The effectiveness of this tool was limited since it left the initiative with the member banks. The elimination of the preferential rediscount rate on government securities was a necessary part of this restrictive credit policy. Banks tended to rediscount securities that enjoyed the lowest rediscount rate; in practice these rates became the effective rates. If credit was to be restricted, this difference had to be eliminated. The sharp decline in the price of these securities was an unfortunate result of this change. However, the policy was necessary and certainly indicated no attempt by the Federal Reserve to force down the price of government securities.

In Montana, the Federal Reserve System followed a realistic policy. Banks were generally in a difficult financial position and many were greatly overextended. The alarming financial condition

[1]Joseph Kinsey Howard, Montana: High, Wide, and Handsome (New Haven, 1943), 210-234 passim. Cited hereafter as Howard, Montana.

of Montana banks[2] made the Federal Reserve Bank of Minneapolis reluctant to encourage further credit expansion by lowering the rediscount rates. Indeed, it seems doubtful that lower rediscount rates would have provided a solution to the difficulties. When banks are heavily overextended as they were in Montana in 1921, an easy credit policy is not the answer to a strengthening of the banking system. The Federal Reserve System could not prevent bank failures that were the result of unwise bank policy. Government supervision could not compensate for poor bank management.

The objectives of the Federal Reserve System did not include the support of existing price levels. The charge that the Federal Reserve System attempted to force down agricultural prices[3] was without merit. Agricultural prices were determined largely by world-wide conditions during this period. The agricultural price declines of the early 1920's had no significant relationship to Federal Reserve policies in the Ninth District.

The role of the Federal Reserve System in the control of credit had not fully crystallized by the early 1920's. It was a relatively new organization. While it is evident that the Federal Reserve System could have acted more vigorously to curb the deflationary spiral, it is equally clear that it did not pursue a policy of forcing a radical liquidation upon the banking system. Indeed, its credit extensions allowed many banks to continue to carry large amounts of overdue paper.

[2] Supra, Table 18.

[3] Howard, Montana, 212. The author charges that the Federal Reserve felt that agricultural products were inflated in value and decided to pursue a policy of deflating farm prices.

Within the framework of economic theory accepted by Federal Reserve officials, the policies of the Federal Reserve Bank of Minneapolis were reasonable. Certainly, Federal Reserve policy cannot be regarded as a major cause of bank failures in Montana during this period.

The agricultural conditions of the early 1920's were another important factor in Montana bank failures. Generally, Montana banks were closely related to the rural farm economy. Adverse climatic conditions and rapidly falling farm prices and income were faced by a highly inflated farm debt. The local drought conditions and the production of agricultural products that were heavily dependent upon export demand left Montana in a difficult position. With the agricultural crisis, many banks were unable to withstand the financial strain. Certainly, the widespread wave of bank failures in Montana during the early 1920's was in part a reflection of this agricultural distress.

The financial strength of many banks allowed them to withstand the economic crisis of the early 1920's. Not all banks were overextended and those that were successful in maintaining depositor confidence and earnings were often able to survive. Generally, the balance sheet accounts of Montana banks in 1920 revealed a relatively weak financial condition. Financial ratios and account balances of Montana banks, when compared with nation-wide averages, partially explain the higher failure rate. In each comparison made, Montana banks reflected a weaker financial condition. This financial position was an important factor in the ability of banks to withstand the strains of the period.

The size of a banking institution was often related to its financial strength. Generally, small banks lacked the ability to properly diversify their earning assets. This left them heavily dependent upon the local economy. When local economic conditions deteriorated as they did in Montana following the First World War, banks were often unable to withstand the strain. As a result many of the banks in these areas failed.

Numerous causes existed for the bank failures in Montana during the early 1920's. Governmental policy, agricultural factors, financial strength and bank size were all important parts of the bank failure pattern. It was a combination of these factors that produced the tragic bank failures of this period. The lessons taught by these events were significant in the years that followed. A new banking code was passed in Montana in the late 1920's that strengthened the state banking system. In addition, the role of the Federal Reserve System was further crystallized. In these and many other ways, the tragic failures focused attention on the weakness of the existing banking system. The changes and improvements made as a result of these experiences produced a stronger banking system. Certainly, the bank failures of this period left their imprint upon the future.

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